

FORM OF REAL ESTATE FRAUD KNOWN AS FLIPPING

HEARING BEFORE A SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS UNITED STATES SENATE ONE HUNDRED SIXTH CONGRESS SECOND SESSION

SPECIAL HEARING
MARCH 27, 2000—BALTIMORE, MD

Printed for the use of the Committee on Appropriations



Available via the World Wide Web: <http://www.access.gpo.gov/congress/senate>

U.S. GOVERNMENT PRINTING OFFICE

63-947 cc

WASHINGTON : 2001

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FORM OF REAL ESTATE FRAUD KNOWN AS FLIPPING

MONDAY, MARCH 27, 2000

U.S. SENATE,
SUBCOMMITTEE ON VA, HUD AND
INDEPENDENT AGENCIES,
COMMITTEE ON APPROPRIATIONS,
Baltimore, MD.

The subcommittee met at 9:35 a.m., in the Maryland Room, World Trade Center, Baltimore, MD, Hon. Barbara A. Mikulski presiding.

Present: Senator Mikulski.

Also present: Senator Sarbanes.

STATEMENT OF SENATOR BARBARA A. MIKULSKI

Senator MIKULSKI. My name is Senator Barbara Mikulski, and I am the ranking member of the Subcommittee on Appropriations, called VA and HUD. And we are officially opening the United States Senate hearing today on the despicable practice called flipping, where the poor are gouged by the scum and scam artists, and then there is the defrauding of the taxpayer by the gaming of the system, therefore leaving us with FHA loans that the taxpayer needs to pick up.

So we have three things here. We have broken dreams by people who thought they had the hope of home ownership. We have the destruction of neighborhoods because of the holding of FHA, where the Federal Government itself becomes a major slum landlord. And we have then the taxpayers holding this liability.

Now, this practice is not only despicable for what it does to people and to neighborhoods and the taxpayer, but it is also criminal. It is absolutely criminal, and Federal laws are being broken and we believe that State laws are being broken.

Now, we in the Senate feel so serious about this that there are two Senate committees investigating this: the VA, HUD Committee on Appropriations, and I will describe that in a minute, as well as Senator Sue Collins' Committee on Government Operations. So if you are a flipper, do not think this is a one-shot deal. If you are a flipper and you are listening to this hearing, this is only one step in many steps that your United States Senate is going to take to protect homeowners, to protect the neighborhoods and to protect the taxpayer.

We are absolutely on their side. We will be listening to testimony from our Federal law enforcement people, the U.S. Attorney, the FBI, the Postal Inspector, who will be giving us, where appropriate,

the information that they are finding as they do ongoing investigations, and also recommendations, and we need to give them the tools to do their job. And last, but not at all least, we are going to hear from our very talented members of the general assembly, who are already working at the State level on the whole flipping issue.

Now, this is a very unusual hearing, not only because of its topic but because of the fact that appropriations does not usually hold field hearings. We have a process in the Federal Government where there is the budget committee and the appropriations committee. My very esteemed and dear colleague, Senator Sarbanes, is on the budget committee. He is also the ranking member on housing and banking. I am on the appropriations. What is the difference?

He will tell you that as ranking, he sets the Federal policy. He does the authorizing, the legislative framework. On the budget committee, President Clinton proposes a budget; the House and the Senate analyze it. And then it comes to the appropriations, where we actually put the line items, the money in the Federal checkbook, to come back to Baltimore, to come back to Chicago, to come back to Dallas, our great communities.

So we are here today, and I cannot thank Senator Sarbanes enough for joining me, this is the first VA, HUD field hearing in 12 years. They do not usually come out to the community. But we are out in the community, and Senator Bond, the Republican chairman of the subcommittee, has his very able staff here to listen to the testimony. He is in Missouri doing his constituent work. But this is a full and official hearing, complete with transcript record and so on.

Senator Sarbanes has graciously agreed to join us because of his own feelings about flipping and because of his desire, as he will tell you, about the whole authorizing part of it. We want to thank Senator Bond for allowing me to chair this hearing, because we are here to get the facts about flipping. What is flipping? Why is it happening in Baltimore? Is it happening in other cities? What can be done to stop it? And what can be done to prevent it?

Businesses and people are being gouged. Neighborhoods are being destroyed, and it is despicable and it is going to stop.

Over the past 4 years, shocking facts have come out because of the community leadership. More than 2,000 properties have been bought and resold within 4 months, at 100 percent profit. Some of these properties were bought and resold the same day. More than 10 percent of the FHA mortgages issued in Baltimore in 1997 are in default. Is it because of the homeowner or is it because of FHA?

We want to be sure that being able to buy a home is part of the American dream. But with the flippers, it has become part of the American nightmare of fraud, deception and manipulation. This is unacceptable, and indications are that this is happening all over the country, that this is a virus that is spreading. And I will tell you, the prevention and the immunization is going to start right here in Baltimore.

This is a national problem, and we will be looking at national issues. We believe the best ideas come from the people, and this is why we are listening to you today. We want to acknowledge the

role that the Southeast Community Organization, and other housing advocacy groups, through their Committee on Predatory Lending, played in bringing this to light. And thanks to the Sun Paper for their investigative journalism that really highlighted it and enabled me to take this to my colleagues in the Senate who asked for national intervention.

Flipping is not just about property. It is about lending practices. It is about aggressive solicitation. It is about deceiving the home buyer, gaming their credit, robbing appraisers, steering people to high-rate lenders, and kickbacks to mortgage brokers. Under every rock we are finding another rock. And under that rock we are finding worms and scams.

But we are here today to get to the bottom of it. When crooked lenders team up with crooked appraisers, with people who are essentially the initial scam, innocent people are roped in. Their property values are artificially inflated in neighborhoods, and it affects the whole neighborhood. It appears, unfortunately, that our own Federal Government may be part of the problem.

HUD, Housing and Urban Development, is holding a large number of single-family homes in an area. Failure to properly dispose of this inventory may be contributing to this problem. And in many cases, it appears that FHA is insuring loans that should have never been made, because of their way of doing business and also by the way they set themselves up to be gamed.

As a Senator responsible for FHA's budget, I am responsible about the financial impact on the FHA insurance fund. And I know Mr. Quayle will have a lot to say about the liability that we hold.

We are going to hear first from people who have been scammed. And we look forward to hearing from Ms. Simon and Ms. Adams. We really want to thank you for testifying today and coming forward. It is not easy to come forth and talk about how you have been gouged and misled. And so we thank you for your courage in coming forth. You are really going to make a national contribution. This is not about hazing. We are not going to put our glasses down and grill you. You are not the problem. You are not the problem.

And of course we listen to Mr. Strong; Ms. Washington; and Mr. Quayle, from St. Ambrose Housing, because it is the community groups that have identified the system. Later we will be hearing from Ms. Battaglia, our very able U.S. Attorney; the FBI and the Postal Inspector; and then from our delegates who are already very busy, working on solutions for flipping.

I would like to now turn to Senator Sarbanes for any comments that he wishes to make. But I think all of America can feel very proud of what Senator Sarbanes is doing in his role in housing and banking. Most recently he has been a strong champion of preserving the Community Reinvestment Act, as well as ensuring the proper framework for HUD's core programs. But in Community Reinvestment, there were those who wanted to eliminate it altogether, and he was in the front lines, preserving it. So that if we can invest in prosperity zip codes, we can invest in those neighborhoods we want to become prosperity zip codes. And he has been a leading champion of that. And I can assure you, he is very much on your side on flipping.

Senator Sarbanes.

STATEMENT OF SENATOR PAUL SARBANES

Senator SARBANES. Thank you very much, Barbara. I want to commend Senator Mikulski for holding this important hearing.

I want to welcome the witnesses, a number of whom we have worked together with over the years on a range of problems. Like Senator Mikulski, I wanted to express my particular appreciation for the witnesses who have been victimized in these terrible frauds that have been perpetrated against them. I know it is not easy to come forward and tell your story publicly. And we understand and appreciate your being here. I have to say to you, your willingness to do so may serve to help others to avoid the terrible experience you have been through. So I think you are performing a real public service and we thank you very much for coming this morning.

The cynicism of the actions of the investors, appraisers, settlement agents and others involved in the flipping scandals here in Baltimore is hard to exceed. Home ownership is the American dream. It is the opportunity for people to put down their roots and start creating equity for themselves and for their families. It has been the path to building wealth for generations of Americans, for ensuring stable communities, good schools, safe streets.

The flippers play on these hopes and aspirations to defraud and cheat people. And I think it is contemptible what has been taking place. We have to do everything we can to make sure the U.S. Attorney's Office and the other law enforcement agencies from whom we will be hearing later in the morning, involved in investigating these crimes, have the necessary resources. And we need to be sure the public is adequately informed and that counseling is provided to help people in this city and elsewhere to avoid these scams.

I also want to touch for a moment not on what is just clearly some criminal activity, but also on another problem that is very troublesome. And that is predatory lending. Predatory lenders target people with a lot of equity in their homes. They underwrite the property without regard for the ability of the borrower to pay the loan back. They make their money by charging extremely high origination fees and by packing other products into the loan, including up-front premiums for credit life insurance or credit unemployment insurance, et cetera. They get large commissions out of that.

Those premiums for those products are financed into the loan, increasing the loan's total balance, so the borrower finds themselves in extreme financial trouble right from the beginning. Then, when trouble hits, the predatory lender will often offer to refinance the loan.

Unfortunately, another characteristic of those loans is they have prepayment penalties. So by the time the refinancing takes place, with all the fees repeated and the prepayment penalty concluded, the lender/broker makes a lot of money out of the transaction and the owner has been stripped of their equity in their home, and often the home itself.

So they find someone, and then they just kind of pull everything out of it and leave them sort of almost destitute. Unfortunately, most of these practices which end up leaving people in dire financial straits, such as those that are affected by flipping, we do not

have adequate legal safeguards to deal with them. Taken together, flipping and predatory lending I think are a frontal assault on homeowners all over America.

And I want to commend Senator Mikulski again, because I think this hearing is a very important step in trying to find solutions. Let me just address the FHA. And I know there have been concerns about creating high rates of foreclosures which contribute to the destabilization of neighborhoods. FHA, of course, is a program designed to push home ownership rates to higher levels. Actually, a GAO study has shown that the vast majority of FHA borrowers would not be able to become homeowners without this government program. And we need to keep that in mind.

Unfortunately, a number of bad actors have used FHA insurance to make bad loans that end up in foreclosure. FHA, we have done our best to make them aware of this problem. I think they are becoming increasingly sensitive to it. HUD has now begun a program, called Credit Watch, which is designed to uncover bad lenders, to remove them from the FHA programs. Since it began, they have tried to terminate about 40 lenders from the program. But this action is being challenged in the courts.

So we need, I think, some legislation to, in effect, strengthen HUD's ability to terminate the bad lenders. And we are working on some legislation of that sort now, which we hope to be able to introduce in the near future. This would give an underpinning to Credit Watch and enable it actually to work the actually the way it is supposed to work.

I look forward to the testimony this morning. This is a very well-structured hearing. And I know we have a busy morning ahead of us. I am very pleased to join Senator Mikulski and I thank the witnesses for appearing.

Senator MIKULSKI. Thank you very much, Senator Sarbanes.

We wish to acknowledge our very able staff that are here. I note you brought Jonathan Miller, from the Senate Banking Committee, to participate. My own staff is Paul Carliner and Sean Smith. And Senator Bond has his able staff, Mr. Kim, who is here.

We are going to turn to our witnesses now, but before we do I want to acknowledge that there are many in this room who would also like to have given testimony but, because of time, we could not. For anyone who has any information they would like to submit for the record, at the conclusion of this hearing, Mr. Smith—Sean, do you want to stand up, please—will take that, and we will enter it into the record.

We know that the professional Realtors have a whole approach to this, and we welcome them submitting their written testimony for the record. We know that Ed Rutkowski, has written a rather detailed memo on what has happened north of Patterson Park, and we will be putting that in the record. And there will be other things we are going to do. So even though not everybody might be before a microphone, we want to be sure that if anyone has views, we would be happy to include them in the record.

Now, I would like to turn to our panel. And what I would like to suggest is we just go straight down, starting with you, Ms. Adams. And if you would introduce yourself and give your testi-

mony, and then Ms. Simon, then Ken, then Ms. Washington, and then, Vinnie, I am going to ask you to be the wrap-up.

Ms. Adams, would you please proceed.

STATEMENT OF CHASSIE ADAMS

Ms. ADAMS. Good morning. My name is Chassie Adams, and I live at 610 North Robinson Street, Baltimore, Maryland. I work for Carlton Data Processing as a data entry operator. I have been employed there for 7 years. I am a single mother with two children, and I attend Mount Pleasant Church. I am here before you today because I purchased a home from Robert Beeman. Buying this house was the start of some difficulties that continue until this day.

I was renting a three-bedroom house in the section Patterson Park of Baltimore when I was introduced to Mr. Beeman. I met him through a personal referral, and he explained to me that I could buy a renovated house for \$500 down. Because he had been referred to me through someone I trusted, I felt I could trust him to be true to his word.

I spent one day riding around with him, looking at houses. He showed me property that he owned and was going to renovate to suit my tastes. After some thought and talking to family and friends, I decided to buy the house. I told Mr. Beeman that I wanted to buy the house on North Robinson Street. And Mr. Beeman told me he would take care of everything. He told me he would arrange for the financing, contact a settlement agent, and even help with straightening out my credit. I explained that I had some debts that might affect my credit status, but he told me that was no problem.

He said that the bank would pay off my old debts and include the payment money in the loan. It all seemed too good to be true, and it was. Shortly after settlement, I started calling Mr. Beeman about things that still needed fixing. Sometimes he responded with quick, patch-up repairs that did not correct any of the problems. Other times he would not respond at all, or he would have me contact one of his staff, who mostly just took messages.

I realize now that I should not have moved into the house prior to all of the repairs being completed. I did so because Mr. Beeman assured me that he would complete the repair work. The work was never completed. There are leaks from bad plumbing, hazardous wiring and other things that need to be corrected.

Additionally, I was forced to file for Chapter 7 bankruptcy partly because those accounts that were supposed to be paid off at settlement were not. By the time my mail caught up with me at my new address, all the accounts were in collection. I had to seek protection from the courts, and this continues to be a problem.

I obtained a \$56,000 mortgage on a property that was sold to me for \$84,000. This same house has recently been reappraised for \$35,000.

Senator MIKULSKI. Ms. Adams, could you repeat those numbers again, please?

Ms. ADAMS. I obtained a \$56,000 mortgage on a property that was sold to me for \$84,000. This same house has recently been reappraised for \$35,000. Also, I now know that the mortgage itself

was very inappropriate for a first-time home buyer. It was a 15-year balloon, with 179 payments, at \$650, and one final payment of \$52,000, which I am sure would have been impossible for me to make.

PREPARED STATEMENT

I have applied for a refinancing loan with First Mariner Mortgage, which will include money to do repairs and pay off the old mortgage. I hope that this will be the end of all the hard times and the beginning of regular home ownership.

[The statement follows:]

PREPARED STATEMENT OF CHASSIE ADAMS

My name is Chassie Adams. I live at 610 North Robinson Street, Baltimore. I work for _____ as a data entry operator. I've been employed there 7 years. I am single, have 2 children and attend _____ church.

I am here before you today because I purchased a home from Robert Beeman. Buying this house was the start of some difficulties that continue until this day. I was renting a 3 bedroom house in the section Patterson Park of Baltimore when I was introduced to Mr. Beeman. I met him through a personal referral, and he explained that I could buy a renovated house for \$500.00. Because he had been referred to me through someone that I trusted, I felt that I could trust him to be true to his word. I spent one day riding around with him looking at houses. He showed me property that he owned and was going to renovate to suit my tastes. After some thought and talking to family and fiends, I decided to buy the house.

I told Mr. Beeman that I wanted to buy the, house on N. Robinson Street and Mr. Beeman told me that he'd take care of everything. He told me that he would arrange for the financing, contact a settlement agent and even help with straightening out my credit. I explained that I had some debts that might affect my credit status but he told me that was no problem. He said that they (the bank) would pay off the old debts and include the payment money in the loan. It all seemed too good to be true, and it was.

Shortly after settlement I started calling Mr. Beeman about things that still needed fixing. Sometimes he responded with quick patch-up repairs that didn't correct any of the problems. Other times he wouldn't respond at all, or he would have me contact one of his staff who mostly just took messages.

I realize now that I shouldn't have moved into the house prior to all of the repairs being completed. I did so because Mr. Beeman assured me that he would complete the repair work. The work was never completed. There are leaks from bad plumbing, hazardous wiring and other things that need to be corrected.

Additionally I was forced to file for chapter 7 Bankruptcy partly because those accounts that were supposed to be paid off at settlement weren't. By the time my mail caught up to me at my new address all the accounts were in collection. I had to seek protection from the court and this continues to be a problem.

I obtained a \$56,000.00 mortgage on a property that was sold to me for \$84,000.00. This same house has recently been re-appraised for \$35,000.00. Also I now know that the mortgage itself was very inappropriate for first time homebuyers. It was a 15-year balloon with 179 payments @ \$650.00 and one final payment of \$52,000.00 which I am sure, would have been impossible for me to make. I've applied for a refinancing loan with First Mariner Mortgage, which will include money to do repairs and pay off the old mortgage. I hope that this will be the end of the hard times and the beginning of regular homeownership.

Senator MIKULSKI. Thank you very much.

Ms. Simon.

STATEMENT OF DIANE SIMON

Ms. SIMON. Good morning. My name is Diane Simon. I live at 3205 Chesterfield Avenue with my husband and my two children. I have been employed at Blue Cross and Blue Shield as a support clerk for 10 years. I would like to speak regarding the purchase of the home I bought from Robert Beeman in November 1997.

At the time, I was renting a two-bedroom apartment in the BelAir-Edison area. My family needed more room, and I thought that home ownership was ever present. I felt the time to own a home had come. And I was introduced to Beeman through a fellow co-worker, so I figured I would give it a try, because she was excited and she bought the home and he fixed the home up for her and she told me a lot about it. And I said, let me call and give me a try. She gave me his number.

We went out looking for houses with Mr. Beeman. And I did not particularly care for the area and the houses that initially were shown. He told me that he owned others, and we went to 3205 Chesterfield Avenue. I felt the house was nice enough and I felt that the area it was in seemed stable and safe. After explaining that he would do all the repairs and make the house look like I wanted it to, I agreed to purchase the house.

I did not know anything about financing or mortgages, and Mr. Beeman reassured me that he could arrange for all the financing. All I needed was \$500 down. And he did take care of everything. Mr. Beeman brought all the papers that I was to sign to my house. He set up a closing date less than one month from the time I first saw the house. The repairs were never completed. As we neared the settlement date, I wondered if things would be ready before we closed.

My calls to Mr. Beeman were responded to initially, but the work was never finished. I decided to move into the house and trust that he would finish the work. To this day, my roof continues to leak and I have the need for major plumbing repairs. There is very low water pressure and I have been told that this condition should not have passed appraisal.

I have been hesitant to make any repairs myself, because we just did not know that we would be able to remain in the house. Additionally, I have since learned that the mortgage I obtained is not one that has a fixed rate. The initial rate is 10.5 and can escalate to 17. This means the \$65,000 mortgage on a \$77,000 sales price will generate \$158,000 in finance charges. The new appraisal for my house is \$50,000, and I am hoping to refinance the mortgage with First Mariner.

PREPARED STATEMENT

As a first-time home buyer, I realize now that I should have sought counsel before buying this house. I just felt that there was enough protection in the process to ensure that something like this could not occur. I was wrong. However, I remain determined to accomplish my original intent, which is to own a home of my home.
[The statement follows:]

PREPARED STATEMENT OF DIANE SIMON

My name is Diane Simon. I live at 3205 Chesterfield Ave. with my husband and two children. I am employed as a support clerk by Blue Cross and Blue Shield of Maryland where I've worked for 10 years.

I would like speak to you regarding the purchase of my house. I bought my house from Robert Beeman in November of 1997. At the time I was renting a 2-bedroom apartment in Belair Edison. My family needed more room and the thought of homeownership was ever present. I felt the time to own had come and after being introduced to Mr. Beeman by a fellow worker, I thought I'd give it a try.

I went out looking for houses with Mr. Beeman and I didn't particularly care for any of the houses that I initially was shown. He told me that he owned others and we went to 3205 Chesterfield Ave. I felt the house was nice enough and I felt that the area it was in seemed stable and safe. After explaining that he would do all the repairs and make the house look like I wanted it to, I agreed to purchase the house.

I did not know anything about financing or mortgages. Mr. Beeman reassured me that he could arrange for all the financing, all I needed was \$500.00. And he did take care of everything. Mr. Beeman brought all the papers that I was to sign to my house. He set up a closing date less than one month from the time I first saw the house.

The repairs were never completed. As we neared the settlement date I wondered if things would be ready before we closed. My calls to Mr. Beeman were responded to initially, but the work was never finished. I decided to move into the house and trust that he would finish the work. To this day my roof continues to leak and I have the need for major plumbing repairs. There is very low water pressure and I have been told that this condition should not have passed appraisal.

I have been hesitant to make any of the repairs myself because we just didn't know that we would be able to remain in the house. Additionally, I since learned that the mortgage I obtained is not one that has a fixed rate. The initial rate of 10–50 percent can escalate to almost 17 percent. This means that my \$65,000.00 mortgage on a \$77,000.00 sales price will generate \$158,000.00 in finance charges. The new appraisal for my house is \$50,000.00 and I am hoping to refinance the mortgage with First Mariner.

As a first time homebuyer, I realize now that I should have sought council before I brought this house. I just felt that there was enough protection in the process to ensure that something like this couldn't occur—I was wrong. However I remain determined to accomplish my original intent, which is to own a home of my own.

Senator MIKULSKI. Thank you very much, Ms. Simon.

Now we would like to hear from Ken Strong. In addition to your job at SECO, you are identified with the Coalition to End Predatory Real Estate Practices.

STATEMENT OF KEN STRONG, EXECUTIVE DIRECTOR, SOUTHEAST COMMUNITY ORGANIZATION

Mr. STRONG. Yes, thank you. I am the Executive Director of the Southeast Community Organization, an umbrella group in Baltimore that you, Senator, well know began some 30 years ago, when a threat to the neighborhoods of southeast Baltimore was in the form of a Federal highway plan that would have paved over Fells Point and Canton. Your leadership then helped thwart that threat to the community. But today, the neighborhoods of southeast Baltimore are threatened by mortgage scams and flipping schemes.

I became aware of the problem about a year and 4 months ago through an attorney, Andrew White Smith, who was representing over 100 victims of William Beeman and Walter Duersch. And he thoughtfully asked nonprofit organizations to help the families that he knew would not be helped alone through the civil law process and through the courts.

So a number of us in southeast Baltimore came together, Ed Rutkowski, from Patterson Park Community Development Corporation; Mike Braswell, from Neighborhood Housing Services, and others. And as we studied the problem, we quickly realized that this was not just a problem for southeast Baltimore, it was a problem really across the city and across the country.

I want to show you a map that illustrates this, if I can. Once we realized the breadth of the problem, we formed a group called the Coalition to End Predatory Real Estate Practices. And this group had citywide participation from housing organizations, neighborhood associations. We had participation from government agencies,

enforcement agencies from the real estate industry. And it has been the major forum through which people have shared information about the flipping schemes and mortgage scams in Baltimore.

One of our most active participants is Carmen Rositora, a home-builder with HUD, a great program. She gave us technical assistance and produced this map that shows the racial demography of Baltimore. The more green, the more African American the neighborhoods. The more blue, the darker the blue, the more white the neighborhoods are.

And you can see the wide scope of the neighbor of property sales that increased by more than 100 percent in less than 4 months in a 3- to 4-year period. We have over 2,500 incidents of this. Not all of them are bad real estate transactions. Some of them are smart real estate. And there are some exceptions to the rule. But I would submit to you that the vast majority of these are the bad actors and the bad characters who wreak havoc on the neighborhoods.

You will also see here how the concentration of these marks are in neighborhoods of racial change. The flipping schemes and mortgage scams are really the modern form of blockbusting in these neighborhoods, where the scam artists are buying houses cheaply from whites who are moving out of neighborhoods that are changing and becoming more African American, and then they are selling houses at these exorbitant rates, under-repaired, overvalued and at huge interest rates, and creating a weak neighborhood from one that had been strong.

And you also see that these real estate creditors are focusing on African American neighborhoods as well, in west Baltimore, in northwest Baltimore. They are preying upon some weaknesses in the housing stock and in the real estate in those areas, and making them even weaker.

We are going to go from this overview, closing in on one block, kind of step by step. This helps tell the story about what is going on here.

Ms. Adams and Ms. Simon talked about Mr. Beeman who sold them their houses. He and Mr. Duersch are represented by all of the blue pins on this map. There are more than 130 blue pins that they have been responsible for that fit very much the pattern that Ms. Adams and Ms. Simon talked about.

In addition, the other colored pins represent other people who are doing very much the same kind of thing. And there are dozens and dozens of them. This is a kind of under-the-table industry that has been spreading. And we have learned that they even meet at a restaurant and share information about how to perpetrate these scams. And there are variations on the theme, but they all have the same end product.

Some of them do not always end in the victimization of a new home buyer. And in addition to all of these—and I only took the areas of the Sixth and Seventh Wards, north of Patterson Park. There are other neighborhoods here.

Senator MIKULSKI. Would you read the street names? Because our records, when we go back, we are not going to know the Sixth Ward from the Seventh Ward versus the census tract.

Mr. STRONG. We are looking at neighborhoods immediately north of Patterson Park, from about Wolf Street over to Conklin Street, and from Baltimore Street—

Senator MIKULSKI. Identify them. Your southern boundary is what?

Mr. STRONG. The southern boundary is Baltimore Street.

Senator MIKULSKI. The northern boundary is?

Mr. STRONG. The northern boundary is Egger Street.

Senator MIKULSKI. Western?

Mr. STRONG. The western boundary is Broadway.

Senator MIKULSKI. Eastern?

Mr. STRONG. And the eastern boundary is Conklin.

And there are hundreds, several hundred, examples of these scams right here.

In addition to these pins, because there was not room on the map—

Senator MIKULSKI. It looks like a virus, does it not?

Mr. STRONG. It does. This is a slightly broader area than the one previously described. It includes some of the area of Highlandtown immediately east of Patterson Park, from about Eastern Avenue on the south, up to Baltimore Street on the north, and from Hagen Street on the east to Linwood on the west.

Senator MIKULSKI. Let us get a better look.

Mr. STRONG. This is 178 pins that are all a circle of friends. They buy a house for \$20,000 and they sell it from the right hand to the left hand on the same day for around \$60,000. We believe, and we are not positive but there is an investigation going on into this now, that they then get a mortgage for 75 percent of that value and have about \$25,000 in profit at the end of the transaction. And they pocket too much of it, not enough to keep the higher mortgage payments going, and they have to repeat this over and over again, like a Ponzi scheme.

It is going to fall apart from its own economic weight or from law enforcement activity. And it will be a whole new wave of vacant housing in neighborhoods that are already in stress. So all of these pins are in addition to the other pins on the map.

In the areas of Patterson Park, in neighborhoods north and east of Patterson Park, we have had the highest concentration of flipping and mortgage scams anywhere in the city. And Baltimore may have the highest in the country.

Now, we are going to look at a neighborhood area that is a little closer in, a smaller area. This is Monument Street and McKeldery. And the western boundary is North Kenwood and the eastern boundary is North Decker. And on this map, all of the yellow-colored areas are property flips. And you can see how many there are on certain blocks that totally destabilize a block.

One outcome of this is the pink areas outlying here that, in my testimony, are described geographically. And these areas the State Department of Assessments and Taxation has said so many flips occurred, so many overvalued properties that people living within this area, collectively, were paying close to a million dollars more in property taxes than they should have. And they are taking steps to correct it, but look at all the other neighborhoods around that

they have yet to get to that are facing that same kind of overtaxing because of overvalued predatory real estate.

In addition, on this map there are dots on certain properties, in properties that are colored in pink or orange. Those properties represent the HUD inventory. These houses were acquired in one of the most recent transactions from HUD. And it is often where a scam artist or flipper will get a property cheaply at a HUD auction. And then they sell it quickly at a greatly inflated rate, often based on fraudulent appraisals, sometimes to another investor, sometimes to an unfortunate buyer, with all of the promises and the tales of woe that you have heard from Ms. Adams and Ms. Simon repeated over and over and over again.

One thing that we have seen quite clearly is that houses remain way too long in the HUD inventory. They deteriorate in value and just physically. And when you examine the HUD inventory, many of the houses are in there for a year vacant and having such a negative effect on the community, and it takes so long to turn over.

Senator MIKULSKI. Ken, we are going to have to move along. There are two more panels.

Mr. STRONG. I am going to wrap up real quickly.

Senator MIKULSKI. We want to be able to get to the Q&A, as well.

Mr. STRONG. This is the block we are going to visit this afternoon. And I will save more of this for the field visit to the 600 block of North Robinson Street. But there are several vacant houses, houses that were appraised at \$85,000. This is Ms. Adams' house, at \$84,000. These prices are more than twice the real value of houses in that neighborhood. And, collectively, it is ruining this block and this community. We will talk more about that this afternoon.

I want to call your attention to a letter that is at the very end of your packet of testimony that I just received at the end of last week. It is from Conti Mortgage Corporation. Conti Mortgage Corporation is a subprime lender who has been involved in many of the Beeman and Duersch cases. They could be called a predatory lender.

They have sent this letter to people who have mortgages through NHS, and have said that they want to offer new mortgage reduction programs, and that they are going to be offering this restructuring concept free and that it will tie into the home value guarantee program that Ed Rutkowski and the Able Foundation have put together. We suspect that this is just a churning of good loans into bad loans. And they have targeted, again, the neighborhoods of Patterson Park. It is mentioned in this letter. This is the kind of thing that we need to stop, with your help.

PREPARED STATEMENT

And no where in the HUD budget is there a line or a program that redresses the problems that we have seen here today. And they are in New York and Chicago, in California, in Buffalo. It is a national problem and we need national solutions to it.

Thank you.

[The statement follows:]

PREPARED STATEMENT OF KEN STRONG

Senator Mikulski and Senator Sarbanes, thank you for inviting me to testify this morning on a matter of critical importance to our southeast Baltimore Community, our city, state, and nation. My name is Kenneth Strong. I am the executive director of SECO, the Southeast Community Organization, and the president of SCDC, the Southeast Community Development Corporation. Seco and SCDC are sister non-profit organizations who for more than a quarter of century have worked hard to protect and uplift the neighborhoods and the residents of southeast Baltimore. It was the threat of federal highway plans that gave birth to SECO thirty years, as both of you, especially Senator Mikulski, well know. Today the most serious threat to the survival of southeast Baltimore neighborhoods is the proliferation and concentration of predatory lending and predatory real estate practices.

Mortgage scams and flipping schemes have wreaked havoc on several neighborhoods in our area, particularly those north and east of Patterson Park. I became aware of the scope of the problem fifteen months ago through an attorney, Andre Weitzman, and called non-profit allies together to see how we could assist victims of the scam and put an end to these practices. We quickly learned that neighborhoods and families throughout the city were similarly preyed upon. So we formed the coalition to end predatory real estate practices and widened our circle of concerned professionals. Participants in the coalition meetings have included community development corporations, fair housing agencies, providers of legal services, city, state and federal agencies, and various industry representatives. The coalition has been the central forum where information about mortgage scams and flipping schemes is shared and where ideas to end these practices are spawned. It is a diverse and open forum; therefore I don't purport to speak for all participants.

Mortgage scams, flipping schemes, and predatory real estate practices cover a multitude of sins and come in various forms. What they have in common is that they are designed to defraud someone. In many cases it is a low-income first time home buyer, most often an African-American family. In other cases, investors are defrauded. In still other cases buyers and sellers are in collusion and it is lenders and government insurers who are defrauded. Another common aspect of all the scams is that they are based on dishonest and inflated appraisals. And the all too common outcome is abandonment, foreclosure, vacancies, and the destruction of neighborhoods. To illustrate the extent of the problem and how it rests on inflated values, we have prepared some maps and picture boards. The first map shows houses that were resold for 100 percent or more of their original price in a very short period of time. While not every dot on this map is a scam transaction, my research and the research of coalition participants, suggest that the vast majority of them are. Later today we will visit the 600 block of North Robinson Street. The idea that houses on this block were appraised and sold for \$70,000 and \$80,000 or more is absurd. Recent, independent appraisals commissioned by defrauded lenders determined that these houses weren't worth half that amount. Along the 300-600 North Robinson Street corridor, we have identified 25 suspicious real estate transactions, sales that have the earmarks of flipping schemes. It will be self-evident this afternoon what happens to the houses, the block, and the neighborhood in the wake of mortgage scams.

The size of the problem depends on how you gauge it. Several months ago, I reviewed a cross section of housing transaction data provided by the Maryland Department of Assessments and Taxation. I estimated that over 2,500 transactions from 1996-1999 in Baltimore City fit the profile of a probable scam or flipping scheme. More recently I have examined the record of real estate transactions in just the sixth and seventh wards of Baltimore City, areas north of Patterson Park; there were over 1,000 sales in short periods of time where the price went up by more than 100 percent.

Bottom line—it is a very large and pervasive problem. One indice of the problem and how it has grown is reflected in the number of foreclosure petitions filed in Baltimore city. Four or five years ago that number averaged 1,000 to 1,500 a year. In 1999 the rate was 5,000 or more a year, over three times as many. Foreclosures also provide feedstock for predators who buy properties cheaply at auction.

The second point I'd like to make is that real estate predators prey especially on neighborhoods where racial change is taking place. And the impact of their schemes and scams is as devastating as the blatant blockbusting a few decades ago. To illustrate this fact, we have two maps. One shows the spread of suspicious sales transactions against the racial demography of the city. The disparate impact on African-American neighborhoods and the concentration of such sales in neighborhoods on the fault line of racial change is evident.

The second map shows 178 transactions all conducted among a close circle of incestuous buyers and investors. This map does not reflect the dozens of other operators with similar sales profiles, but smaller volumes, who have inflicted their harm on these same neighborhoods. One of our coalition members, Ed Rutkowski, wrote a book about this area called "The Urban Transition Zone", analyzing this phenomenon. Due to the tremendous impact of mortgage scams and flipping schemes, I have recommended that city, state and federal agencies recognize the neighborhoods of Patterson Park as a special impact area and work with us on a program with substantial resources to ameliorate that impact. Such a program could also then be applied in Belair-Edison, southwest Baltimore, Waverly and other neighborhoods particularly undermined by real estate predators.

I have heard some people say that the victims of mortgage scams and flipping schemes are really accomplices and not really deserving of assistance. While this is undoubtedly true in some instances, it does not describe the vast majority of homebuyers SECO and other coalition members have come to know. SECO staff and volunteers visited over 50 families caught in the vice of these practices and conducted in-depth interviews. We found many hard-working heads of households working for low wages who wanted to achieve the American dream for themselves and their children—to own a home. They were duped by people who said they could make that dream come true. They were sold houses that were cosmetically repaired and in some cases dangerous. Documents at settlement were falsified documents; in some cases their signatures were forged or zeroxed from another form. In many cases the documentation of a second mortgage was never shown to them. Even when fake gift letters or phony down payments are arranged to qualify for FHA financing, they are being coached by professional predators who say this is how it's done. They are surrounded by sellers, brokers, title company officials and others in a process they've never experienced before. Don't blame the victims, please; it isn't fair in the vast majority of cases.

In our examination of this problem, coalition members have come up with a number of legislative reforms and ideas. It is undoubtedly a complex problem requiring a complex response. City, state, and federal agencies all need to examine themselves to see if there are any ways that they are enabling predatory lending and real estate practices. We need every level of government to identify and fund recovery plans for neighborhoods most heavily afflicted by these practices. We need law enforcement at every level to focus on the criminals and bring them to justice. We need consumer protection actions that yield restitution for victims to the fullest possible extent. We need non-profit agencies to strengthen the standards and conduct of home ownership counseling with a focus on thwarting predatory practices and we need to expand resources for such education and counseling. The greater Baltimore Board of Realtors has focused on the need for more public education about home buying and home ownership; I applaud those efforts.

In terms of federal agencies and legislation, there are a number of approaches that I would ask you to consider.

1. Foreclosure moratoriums—Once we have identified sellers, mortgage brokers, and lenders who have engaged in a pattern of fraudulent transactions, there should be a moratorium on foreclosures involving those houses. The displacement of families and all the secondary impacts of those dislocations ought not to proceed. During the period of a moratorium the families, non-profit agencies, government agencies, and the private sector can devise creative solutions. We are witnessing just such an outcome for clients of Mr. Weitzman who are eligible for conventional loans and monies for home repairs through the creative problem-solving efforts of First Mariner Bank, the Abell Foundation, and Southeast Community Development Corporation.

2. Restrict the maximum mortgage broker fee which is now 8 percent of the mortgage amount. It encourages the inflation of housing prices. Charging the maximum fee is not justified in most cases and its imposition is a form of price gouging of consumers.

3. Eliminate the "yield spread premium", the additional fee that brokers receive for placing a loan at a higher rate than the buyers are eligible to receive.

4. Credit watch—HUD's efforts to control lenders with unconscionable default rates or other substandard practices needs to be reinforced. A federal judge has questioned HUD's authority to ban bad lenders. We have joined HUD in an amicus brief to override the judge's objections. We may need regulatory or legislative fine-tuning for HUD to exercise the better controls.

5. We applaud the initiatives of U.S. Attorney Lynn Battaglia and Maryland Attorney General Joseph Curran who have made mortgage scam investigations top priorities for their offices. We recommend that attention be paid to the coordination of investigations and prosecutions. We also recommend maximum consideration of

restitution to victims or the creation of property receiverships in the community as endpoints of law enforcement.

6. Predatory lending—Attached to my testimony is draft legislation which a subgroup of the coalition put together aimed at controlling the predatory nature of high interest loans in general. It takes a class of loans above a certain percentage of the prime rate and says that in that class of lending the public needs extra protection. It prohibits certain kinds of lending measures, such as balloon payments and negative amortization. And it requires of lenders that extra measures be taken to insure that borrowers have the capacity to repay a loan. Lending with a total disregard to repayment capacity is a prescription for failure and foreclosure; it is predatory in nature. North Carolina has such a law. We should examine if anything along these lines can be addressed at the national level.

7. We would like to see HUD and FHA put at least as much money and effort into examining how aspects of their programs have contributed to this problem as they put into touting the overall success of what they do. Ed Rutkowski of the Patterson Park Community Development Corporation has submitted testimony outlining a tale of two FHAs, one largely successful in suburbia and strong neighborhoods, the other a dismal failure and a contributing factor to urban blight.

8. Reform the way in which HUD manages and disposes of its properties. HUD houses that stay vacant for a year or more are part of the problem not the solution. Eventually the houses so deteriorate in value that speculators and perpetrators pick them up cheaply for nefarious purposes and a cycle of victimization starts again. Properties should be made more quickly and easily available to competent non-profit developers.

Some members of the coalition say that absolutely no new legislation is needed. I personally disagree with that stance. Under current laws, a grotesque real estate market has developed in parts of Baltimore City that is utterly detrimental to all honest efforts at community development. Under current laws, we allow incentives for brokers to gouge consumers both in terms of fees and interest rates. At high interest rates we allow practices that are predatory in nature. These practices must come to an end and the kinds of legislative reforms discussed above as a whole will help to close the door of real estate profiteering.

I want to end my testimony by referring back to one of the maps. Behind these pins live three hundred children. In these houses we have seen higher levels of lead paint poisoning and cases of asthma. On thus the coldest day of winter thus far, some of these houses were without heat. Some of them still have dangerous electrical systems, holes in the roof and rats in the basement. The American dream of home ownership turned into a nightmare for these families. Theirs is a legacy of continued discrimination and victimization at the hands of greedy individuals who have little or no conscience. It is intolerable. We need your help to end this nightmare.

PREPARED STATEMENT OF ED RUTKOWSKI, EXECUTIVE DIRECTOR, PATTERSON PARK COMMUNITY DEVELOPMENT CORPORATION

My testimony focuses on two aspects of the current flipping crisis: the unrecognized and unacknowledged existence of two markets for homeownership, and the unchecked phenomenon of “investor-to-investor” flipping and mortgage schemes.

TWO REAL ESTATE MARKETS FOR HOMEOWNERSHIP: IMPLICATIONS FOR HUD/FHA

There are two real estate markets in this country as outlined in the table on the following page. The primarily suburban market can be characterized as “healthy,” while its counterpart, the primarily urban market, can be characterized as “weak.” The “healthy” market also includes gentrifying and wealthy urban neighborhoods, and the “weak” market also includes deteriorating first ring suburbs of cities like Baltimore.

Too little attention has been paid to this dichotomy, especially by HUD and FHA who play dominant roles in both markets. HUD policies and programs frequently have profoundly negative effects on communities with weak real estate markets. Examples include an overwhelming emphasis on homeownership without sufficient regard for loan quality, programs like Section 8 that concentrate poverty, and policies on property disposition that do not take into account the neighborhoods in which the vacant houses exist. These issues are covered more thoroughly in other testimony, and in our book, *The Urban Transition Zone—A Place Worth a Fight*.

My testimony concentrates on the fact that HUD/FHA apparently does not recognize the fact that there are two markets, nor does HUD/FHA address the consequences of that fact. Programs, policies and practices that work well in one market do not necessarily work well in another.

As an example, when questioned at Senator Sarbanes' hearing, Mr. Matt Franklin stated that overall foreclosure rates for FHA-insured loans were 3 percent per year. While that is an exemplary figure, that statistic neglects the fact that in some Baltimore census tracts, FHA-insured foreclosure rates exceed 25 percent (source: National Training and Information Center, NTIC, in Chicago—October 1998 data). As a consequence, the 3 percent overall rate masks the very real problems which contribute to, and result from the high foreclosure rates in some city neighborhoods.

Those problems have been discussed in detail in other testimony and include outright fraud with sad consequences for its victims and lenders, large numbers of vacant houses, acquisition of large numbers of properties by irresponsible absentee investors. Indirect consequences include increased middle class flight and further deterioration of urban neighborhoods.

As indicated in the second table on the following page, consequences of high foreclosure rates on FHA-insured loans mirror the consequences of similar foreclosure rates for subprime loans. That is to say that because of the high volumes of loans, FHA practices have the same negative effect as subprime loans. Further, to the extent that HUD's disposition processes are inadequate, the consequences can be even worse.

The two real estate markets:

1. Primarily suburban, but including "hot" urban neighborhoods	2. Primarily urban, but including failing first ring suburbs
Healthy demand	Weak demand
Rising values	Stagnant or falling values
Positive perception and environment for development	Negative perception and environment for development
Low foreclosure rates	High foreclosure rates
Loans are typically free of outright fraud	Loans have significant signs of fraud (e.g. forged documents, greatly overstated appraisals)
Buyers are relatively sophisticated	Buyers are unsophisticated, uneducated, often minorities
Bad deals (e.g. faulty construction) are paid off because of relatively high buyer income	Bad deals (e.g. fraudulent documentation, cosmetic rehabilitation) result in foreclosure because of relatively low buyer income and inability to maintain home

Lender roles in the urban market:

Sub-prime Role	FHA-insured Role
Sub-prime lenders can afford high foreclosure rates because of high interest rates	FHA can afford high foreclosure rates because of the subsidy provided by low foreclosures in successful markets
Effect of high foreclosure rates is severe on urban neighborhoods: <ul style="list-style-type: none"> increased vacancy rates deterioration of housing stock high level of acquisition by irresponsible investors 	Effect of high foreclosure rates is severe on urban neighborhoods: <ul style="list-style-type: none"> increased vacancy rates deterioration of housing stock high level of acquisition by irresponsible investors

It is essential, then, that HUD/FHA recognize and deal with the distinction between these markets in the following ways:

Track and aggregate foreclosure rates separately for the two markets by identifying census tracts in which high foreclosure rates exist.

In communities with high foreclosure rates, implement stricter regulations that will prevent fraud. These have been suggested in other testimony, and include more frequent audits of lender practices, more frequent review of loans made, and increased accountability of appraisers. However, HUD must avoid the “one size fits all” when underwriting loans in these communities. Otherwise, legitimate loans will not be made to deserving borrowers who do not match the “suburban type.”

In some communities with high foreclosure rates, there is capacity to partner with HUD to improve housing stock through non-profit organizations like the Patterson Park CDC. HUD’s Asset Control Areas are a good beginning. However, further possibilities should be examined, such as partnerships that renovate properties while still under HUD ownership. Other flexible arrangements should be studied and implemented.

Subsidize neighborhood redevelopment in fragile urban neighborhoods with high foreclosure rates. As matters stand, insurance premiums from healthy markets subsidize excessive losses in weak markets. It would be wiser to subsidize neighborhood redevelopment to prevent high foreclosure rates.

Consider the possibilities using the neighborhoods around Patterson Park as an example. In an area of approximately 3,000 houses, we believe that in the recent past there have been about 50 FHA foreclosures per year. If HUD loses \$25,000 per foreclosure, that represents a loss of \$1,250,000. There is every reason to believe that the number of foreclosures could be reduced to 10 per year: there were less than 5 total foreclosures (including non-FHA) in 1989. Ten foreclosures per year would net HUD a savings of \$1,000,000 per year.

According to our records, in 1999 the average HUD foreclosure occurred at a price of \$54,000. HUD sold at an average price of \$32,000, not including various discounts. This would indicate that the average cost to HUD of these foreclosures was well in excess of \$25,000.

Implement a pilot program to test this idea in several cities/communities. That is, for the next ten years, invest directly at least \$1,000,000 per year in community-based organizations to determine the extent to which foreclosures can be reduced.

Finally, conduct an analysis of each real estate market: “healthy” and “weak.” Use that analysis, in conjunction with the advice of local practitioners to develop insurance programs and housing strategies that actually suit those markets. This would avoid the “one size fits all” approach that does not work today.

INVESTOR-TO-INVESTOR FLIPPING AND MORTGAGE SCHEMES

In the recent publicity about “flipping,” most attention has been paid to fraud involving flipping of homes from investors to first time homebuyers. Less publicity has been paid to schemes which defraud lenders in transactions between two investors. This is not a problem related to the circumstances described above—these loans are rarely insured by FHA. However, this is an important issue that must be diligently investigated and prosecuted by appropriate authorities.

Many of these kinds of transactions occur in transitional neighborhoods where market appreciation is weak or non-existent. In fact, property values are often falling. In addition, rents are often low and stagnant, and the economic circumstances of tenants often dictate frequent tenant turnover with consequent high operating costs.

In this environment, it is very difficult, if not impossible to make money as a responsible landlord. Therefore, a number of investors have developed a scheme in which money can be taken out “up front” by creating a mortgage based on an appraisal that overstates the value of the property. In order for these schemes to work, there is some evidence that outright fraud is a necessary component. The following paragraphs highlight the mechanics.

A typical transaction:

- A buys a property for \$9,000, plus \$2,000 in settlement costs
 - A performs cosmetic rehabilitation for \$6,000, now having \$17,000 invested
 - A sells to B for a contract price of \$47,000, based on an overstated appraisal
 - A helps B secure a mortgage for \$37,000, possible with less than 80 percent loan-to-value (LTV)
 - A issues a (possibly) uncollectable \$10,000 second mortgage to secure the deal, or uses fraudulent or forged documents to demonstrate a \$10,000 down payment
- What happens at settlement?
- Lender provides \$37,000
 - A gets \$27,000 as the “real” purchase price, netting \$10,000
 - B nets \$5,000 in a “cash back” arrangement

—Settlement fees are \$5,000, netting the mortgage broker \$2,500 in “excess” settlement fees (a typical settlement should not exceed \$2,500)

What happens over the course of a year?

—A repeats this process 30 times (10 times for each of 3 B’s.), making \$300,000

—B repeats this process 10 times, making \$50,000

—The mortgage broker repeats this process 90 times (3 times for each of 3 investors), making \$225,000

In 90 transactions (three A’s, nine B’s and one mortgage broker), \$2,025,000 is pulled from the community and lenders before any value is given back by way of housing stock renovation and loan repayment.

What is wrong with this picture? There are a number of reasons to suspect outright fraud. The transactions require appraisals that are unsupported by the real estate market and the level of rehabilitation. The lender is defrauded because it is lending \$37,000 on a \$27,000 house. B is defrauded because the cosmetic rehab will require maintenance beyond that supported by the rent (though B may well buy a BMW with the ten \$5,000 “cash backs” from these transactions, thereby leaving himself insufficiently capitalized to have a successful rental portfolio).

Finally, the neighborhood is hurt because it will very likely have a nuisance tenant (B is not likely a good property manager), and eventually a vacant house when B defaults. At least in Baltimore, the neighborhoods in which this scheme is prevalent are also neighborhoods in which foreclosure rates are high. There is some evidence that concentrations of Section 8 families exist, in these neighborhoods as well. The linkage of these factors in declining neighborhoods argues for additional financial and other resource support for these neighborhoods.

QUESTIONS FOR UPCOMING COMMITTEE HEARINGS

APPROPRIATIONS COMMITTEE HEARINGS ON HUD APPROPRIATION

Do certain census tracts show very high foreclosure rates?

Are HUD houses in those census tracts sold primarily to investors?

In 1998, how much did HUD lose due to foreclosures in high vs. low-foreclosure census tracts, say tract 602 (25 percent foreclosures for loans made between 1987 and 1997) vs. tract 104 (5 percent foreclosures)?

Is HUD doing anything to restore neighborhoods damaged by highly foreclosure rates?

Are there sufficient safeguards for loans insured by FHA, especially in high-foreclosure census tracts?

Do census tracts with high FHA foreclosure rates also have high Section 8 concentrations?

If so, would that implicate HUD in neighborhood deterioration?

BANKING COMMITTEE HEARINGS ON OVERSIGHT

Are FHA-insured lenders sufficiently regulated, especially with regard to appraisals, underwriting criteria?

Is the subprime market sufficiently regulated?

ANDRE R. WEITZMAN AND ASSOCIATES,
Baltimore, Maryland, March 22, 2000.

Hon. BARBARA A. MIKULSKI,
U.S. Senate, Washington, DC.

DEAR SENATOR MIKULSKI: An aggressive review of FHA lending performance in Baltimore City is sorely needed and, under your leadership, I am confident that is precisely what will happen.

I have been working on this issue for the past two years, alone for much of that time, but for the past year in association with the Coalition to End Predatory Real Estate Practices under the capable leadership of Ken Strong.

Ken has advised me that he forwarded a lengthy report to your staff that I wrote for the Coalition last April. In advance of the hearings to be held next week I would like to touch on a few points that have come up during litigation that I have handled, and that have come to my attention through various interactions with members of the Coalition.

In addition, I enclose an outline of the causes of “flipping” that was prepared and submitted with my appearance before Mayor O’Malley’s transition committee on housing. Also enclosed are certain pages from the HUD manual for lenders on FHA loans that I will mention below.

OVERSIGHT AND QUALITY CONTROL

Enclosed are 10 pages from HUD's Directive No. 4060.1—Mortgage Approval Handbook Chapter 6 Quality Control Plan. I obtained this document from HUD's website. Based on testimony from loan officers during pending litigation, it is a document that is required to be retained and updated in every lenders office that originates FHA insured loans.

The directive mandates the creation and maintenance of a written quality control plan, sets standards for selecting loan packages for review, and prescribes reporting requirements.

Most critical to this directive is Section 6-4 (appearing at page 6-7)—Guidelines for Selecting Single Family Loans for Loan Origination Quality Review (highlighted for your convenience).

This section creates twenty "Red Flags" that should alert lenders to questionable loans. In the thirty some sets of loan documents that I have reviewed, at least six red flags appear on the face of the documents, yet none were reviewed and none were turned down.

It seems inconceivable that over 1,000 bad FHA loans could have been made to low income first time home buyers in Baltimore City if lenders had followed the directive for conducting quality control reviews.

Given that most flippers do multiple transactions with the same lender, the repeated appearance of red flags should have alerted lenders to look more closely at transactions originated by the same seller.

However, an inference can be drawn from the high volume of bad loans completed in such a short time that goes beyond mere negligence. Given the highly questionable nature of these loans, lenders may have consciously chosen to ignore the need for corrective measures, which, if reported as required, may have jeopardized their inevitable claims under the FHA insurance fund when defaults and foreclosures would occur.

I am unaware of whether any of the FHA financed flips that went to foreclosure and generated subsequent insurance claims were ever denied coverage by HUD, or ever even investigated.

FORECLOSURE TIME BOMB

Flipping, both subprime financed and FHA financed, has exacerbated the explosion of foreclosures filed in Baltimore City. St. Ambrose has done research that shows the number of foreclosure petitions filed in Baltimore City has risen from an average of 1,000 petitions per year to over 5,000 petitions just since 1995.

FHA financed loans are slower to go into default and foreclosure than are subprime financed transactions, mostly because of the lower payments due under FHA loans and slightly better credit qualification of the borrowers.

However, the grossly inflated appraisals supporting the FHA financed transactions makes it likely that any future transfer of the property can only be accomplished by foreclosure. I reach this conclusion on the assumption that prices obtainable in the "true" market will not increase sufficiently to cover the amount of debt placed on these homes by the phony market under which they were purchased.

At some point property must be transferred, sometimes because of unforeseen circumstances such as death, divorce, or even marriage. At that point a house worth only \$40,000 (or less) in the market for home-owner to home-owner sales cannot be sold if the principal balance on the mortgage exceeds \$50,000.

Baltimore will continue to have a high default rate on FHA loans as circumstances catch up to the victims over the next several years, unless loans are modified to reflect true market values of the properties.

TAX CONSEQUENCES

In many instances I have been able to obtain loan modifications for victims, reducing their indebtedness by 50 percent or more. In those instances lenders issue an IRS Form 1099 and treat the loan reduction as a forgiveness of indebtedness. It is my belief that if the reduction is in connection with settling a disputed claim or lawsuit, then consideration is given making the reduction non-taxable.

There are thousands of low income families nationwide who are in the same position, but who are likely to be unfairly taxed on reductions of loan balances that were fraudulently inflated. through flipping schemes.

DISPOSAL OF HUD HOMES

Among the worst of the collateral effects on neighbors and neighborhoods caused by flipping is the increase in vacant "HUD" homes, and the inordinate length of

time required to re-sell the property. At a minimum a HUD home is vacant for at least a year. The impact on adjacent home owners can be devastating in terms of property value, neighborhood appearance, and public safety issues.

STRENGTHEN HOME OWNERSHIP COUNSELING AND EDUCATION—CREATE A RIGHT OF RESCISSION

In instances where home ownership counseling is mandatory, it is often done hastily and on the eve of settlement when counseling is least effective.

I have suggested a method for increasing the effectiveness of home ownership counseling without necessarily increasing the funds required to provide counseling.

A standard can be established, based on the income level of the borrower or the availability of public money to subsidize the transaction, under which mandatory counseling must be obtained during a set period of time that would be co-extensive with an absolute right to rescind and cancel the transaction being afforded to the buyer/borrower. If the counseling is not obtained, then the public subsidy could be withheld, or the loan made ineligible for FHA insurance.

This concept is similar to the right of rescission provided by the Truth-In-Lending Statute, and would protect both the low income buyer and the public from abuses such as we have seen in our recent experience.

A further requirement for mandatory counseling must be that the counseling agency is wholly independent of the seller and the lender, and receives no financial support from persons whose economic interest is adverse to the buyer.

Thank you for taking the time to consider these comments. I am available to you or your staff for any further assistance that you may need.

Respectfully submitted,

ANDRE R. WEITZMAN,
Lawyer.

ROBINSON STREET FLIPS
7/1/96 TO 7/1/99
300 North to 600 North
Compiled by Andre' R. Weitzman from Public Records

ADDRESS	ACQUISITION PRICE/DATE	RESALE PRICE/ DATE	SELLER	FINANCING	STATUS 3/25/00
305	\$17,000 5/15/96	\$45,934 5/15/96	Beeman	Sub-prime (Cityscape)	Occupied
315	\$3000 7/13/98	\$55,900 11/13/98	Holding Pile Residential LLC	FHA (Harbor Financial)	Occupied
316	\$16,000 7/24/97	\$71,500 10/6/97	Beeman (AHOYO)	Sub-prime* (Southern Pacific)	Occupied/ Pending Settlement
418	\$33,000 3/16/99	\$62,000 3/16/99	Joseph V. Smith	Advanta (Sub-prime)*	Occupied
423	\$18,000 10/17/97	\$58,000 10/7/98	W. Duersch (AHIAH)	FHA (American Skycorp).	Occupied
424	\$15,000 6/19/97	\$49,400 1/26/98	James Smith	FHA (Capitol Mortgage Bankers)	Occupied
432	\$15,000 1/4/99	\$54,000 1/4/99	Superior Property	Sup-prime* (Equicredit)	Occupied
434	\$14,250 12/31/98	\$54,000 12/31/98	Superior Property	Sub-prime* (Equicredit)	Occupied
436	\$20,000 11/15/96	\$83,000 2/27/97	Beeman	Sub-prime* (Weyerhaeuser Mortgage)	Vacant/ Pending Settlement

ROBINSON STREET FLIPS
7/1/96 TO 7/1/99
300 North to 600 North
Compiled by Andre' R. Weitzman from Public Records

ADDRESS	ACQUISITION PRICE/DATE	RESALE PRICE/ DATE	SELLER	FINANCING	STATUS 3/25/00
500	\$22,000 12/9/97	\$56,000 5/28/98	L. Duersch (Mayfield Assoc.)	FHA (Capitol Mortgage Bankers)	Occupied
501	\$20,000 10/2/97	\$84,615 12/15/97	W. Duersch (AHIAH)	Sub-prime* (Southern Pacific)	Occupied/ Will vacate Pending Settlement
503	\$26,300 10/18/96	\$51,000 5/27/97	Beeman	FHA (Columbia Bank)	Occupied
510	\$19,000 3/31/97	\$53,000 8/7/97	John Smith Realty, Inc.	FHA (Homestead Mortgage)	Occupied
516	\$18,000 7/23/97	\$82,000 10/6/97	W. Duersch (AHIAH)	Sub-prime* (Conti)	Occupied Pending Settlement
517	\$15,500 2/19/99	\$54,000 4/9/99	New American Properties	Sub-prime* (Presidential)	Occupied
518	\$7,500 2/17/99	\$45,000 3/10/99	Michael A. Sheldon	Sub-prime* (LL Funding)	Vacant
530	\$13,000 6/25/97	\$79,000 9/15/97	Gekko Holding LLC	Sub-prime* (First Keystone FSB)	Vacant
533	\$23,000 2/7/97	\$70,000 4/10/97	Beeman (AHOYO)	Sub-Prime* (Weyerhaeuser)	Vacant

ROBINSON STREET FLIPS
7/1/96 TO 7/1/99
300 North to 600 North
Compiled by Andre' R. Weitzman from Public Records

ADDRESS	ACQUISITION PRICE/DATE	RESALE PRICE/ DATE	SELLER	FINANCING	STATUS 3/25/00
600	\$13,000 1/7/97	\$85,000 4/25/97	Beeman (AHOYO)	Sub-prime* (Weyerhauser)	Vacant
606	\$21,000 6/7/96	\$70,000 7/18/96	Beeman	Sub-prime* (refinanced for \$70,000 by Advanta)	Occupied Settled - loan reduced to \$24,000 by Advanta
610	\$18,000 10/25/96	\$84,000 1/10/97	Beeman	Sub-prime* (Conti)	Occupied Pending settlement
613	\$21,500 9/19/97	\$54,900 1/15/98	George Schiaffino	FHA (Harbor Financial)	Occupied
615	\$27,000 2/18/98	\$52,900 12/15/98	George A. Schiaffino	FHA (Harbor Financial)	Occupied
625	\$21,000 5/9/97	\$83,000 5/9/97	L. Duersch Mayfield Properties	Sub-prime* (Wilshire)	Occupied Pending Settlement
627	\$13,000 10/17/97	\$53,000 10/17/97	L. Duersch Mayfield Properties	FHA (Capitol Mortgage Bankers)	Vacant

*Subprime financing is usually accompanied by a seller second mortgage to make up the difference in the first mortgage and the sale price. The seller seconds are usually undisclosed to the buyer and never collected on. The seller seconds are typically released without consideration when the purchase money loan is refinanced. It can be assumed that all properties are appraised for the sale price prior to settlement.

Many FHA financed transactions received SELP loans through Empower Baltimore or the Baltimore Department of HCD.

There are numerous other suspicious sales based on price, but the acquisition price and date was not available from the records reviewed.

DEPARTMENT OF ASSESSMENTS AND TAXATION

CITY ASSESSMENTS REDUCED DUE TO REAL ESTATE FLIPPING

Property assessments on homes in several neighborhoods in East Baltimore will be reduced an average of 24 percent, as a result of a reassessment done to evaluate the impact of real estate flipping in Baltimore City. The neighborhoods, near Patterson Park, have been the recent focus of high levels of fraudulent real estate transactions.

All real estate in Maryland is normally reassessed on a three-year cycle. However, due to many published reports detailing cases of fraudulent real estate transfers in Baltimore City, the Director of the State Department of Assessments and Taxation recently ordered an out of cycle review of certain neighborhoods two years before their scheduled reassessment. The Department analyzed current real estate sales and existing sales listings, after excluding transactions that appeared to be inflated above market value. The review concluded that several neighborhoods in the Patterson Park area were currently assessed above market value.

Reassessment notices will be mailed to the 3,728 affected property owners on December 27th as part of the larger three-year reassessment mailing. Assessed values for these properties currently average \$46,973 and will be reduced to an average of \$35,950. The new date of valuation will be January 1, 2000 and the changes will be effective for the tax year beginning July 1, 2000.

For further information contact the State Department of Assessments and Taxation at (410) 767-4881.

Detail of Areas Receiving Special Reassessment

Assessment Neighborhood 06.01.01 (Area Description—North of Baltimore Street, East of Lakewood Avenue, West of East Avenue, and South of Pulaski Highway):		
Number of Accounts Adjusted	1,033	
Current Average Value	\$45,271	
Adjusted Average Value	\$34,879	
Assessment Neighborhood 06.01.02 (Area Description—North of Baltimore Street, East of Wolfe Street, West of Lakewood Avenue, and South of Fayette Street):		
Number of Accounts Adjusted	982	
Current Average Value	\$45,024	
Adjusted Average Value	\$36,732	
Assessment Neighborhood 07.01.01 (Area Description—North of Madison Street, East of Luzerne Avenue, West of Edison Highway, and South of Eager Street):		
Number of Accounts Adjusted	492	
Current Average Value	\$42,354	
Adjusted Average Value	\$34,475	
Assessment Neighborhood 26.01.06 (Area Description—North of Baltimore Street, East of East Avenue, West of Haven Street, and South of Pulaski Highway):		
Number of Accounts Adjusted	648	
Current Average Value	\$46,768	
Adjusted Average Value	\$35,991	
Assessment Neighborhood 26.01.07 (Area Description—North of both sides of Lombard Street, East of Highland Avenue, West of Haven Street, and South of Baltimore Street):		
Number of Accounts Adjusted	573	
Current Average Value	\$50,018	
Adjusted Average Value	\$37,695	
Total All Areas:		
Number of Accounts Adjusted	3,728	
Current Average Value	\$46,973	
Adjusted Average Value	\$35,950	

NATIONAL TRAINING AND INFORMATION CENTER,
Chicago, Illinois, November 2, 1999.

KEN STRONG,
South East Community Organization, Baltimore, MD.

KEN: Thanks for the opportunity to present the FHA foreclosure information to the coalition. You have a diverse group that seems dedicated to making something happen to put an end to the property flipping in Baltimore.

On the FHA front you are in a unique position because Senator Sarbanes is the ranking Democrat on the Senate Banking Committee, the committee that oversees HUD and the Federal Housing Administration. This position is strengthened by the fact that Sarbanes may be wanting to please community groups after being part of a financial reform negotiation that essentially guts the Community Reinvestment Act. The following are possible avenues that the coalition could take toward preventing FHA foreclosures and HUD abandonment through Sarbanes.

Homebuyer Protection Plan (FHA appraisal reforms)

Have the local HUD office present their plan for ensuring the implementation of the Homebuyer Protection Plan.

Ask the local HUD office to investigate appraisers that are involved with fraudulent appraisals. These appraisers can be taken off the FHA approved list. We have been successful in doing this in Chicago.

Credit Watch (Lender Monitoring)

Because this program is under attack by the mortgage bankers it is extremely important that Senator Sarbanes knows that community organizations support this HUD effort and that they want HUD to continue to develop legal strategies that cutoff lenders with extremely high default rates.

Foreclosure Prevention

Push Sarbanes to advocate for a moratorium on foreclosures for families who bought over appraised homes with FHA loans and have HUD be aggressive in pushing lenders for Loss Mitigation tools to restructure loans for families. We were able to keep hundreds of families in their homes through the agreements we reached in Buffalo and Chicago.

Property Disposition

Push Senator Sarbanes to create Asset Control Areas in Baltimore neighborhoods that have community development corporations with the capacity to redevelop large numbers of HUD properties. Ed Rutkowski from Patterson Park seemed especially interested in bringing this pilot to his area.

If you have any questions about these avenues or want to talk about other ideas that you are considering, please feel free to give me a call. Also, I would suggest that you have a conversation with Jason Kiely from our office about what groups around the country are doing on the issue of predatory subprime lending. He has quickly become a national expert on the issue and is organizing around a state bill that would tighten the screws on predatory mortgage brokers and subprime lenders.

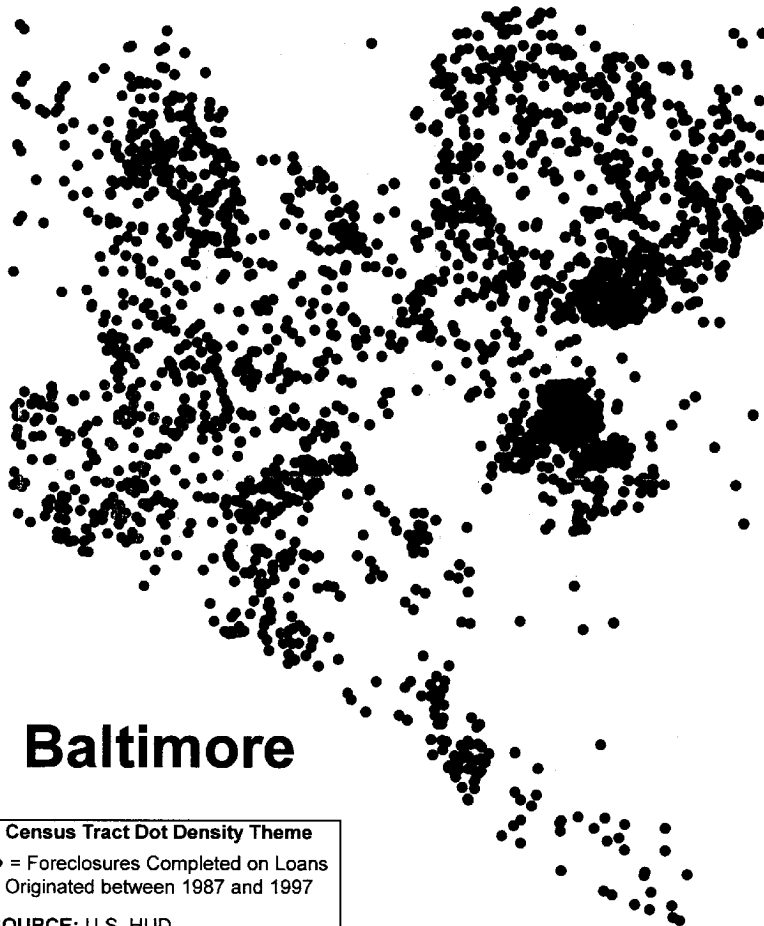
Sincerely,

GEORGE GOEHL,
Housing Director.

NTIC National Training and Information Center
810 N. Milwaukee Ave. □ Chicago, Illinois 60622-4103 □ (312) 243-3035

Foreclosures Completed

2,506 Foreclosures Completed as of October 1998



NTIC National Training and Information Center
810 N. Milwaukee Ave. □ Chicago, Illinois 60622-4103 □ (312) 243-3035

Foreclosures Started

677 Foreclosures Started as of October 1998



Baltimore

Census Tract Dot-Density Theme

● = Foreclosures Started on Loans
Originated between 1987 and 1997

SOURCE: U.S. HUD

NTIC National Training and Information Center
810 N. Milwaukee Ave. □ Chicago, Illinois 60622-4103 □ (312) 243-3035

Delinquencies

946 Seriously Delinquent Loans as of October 1998



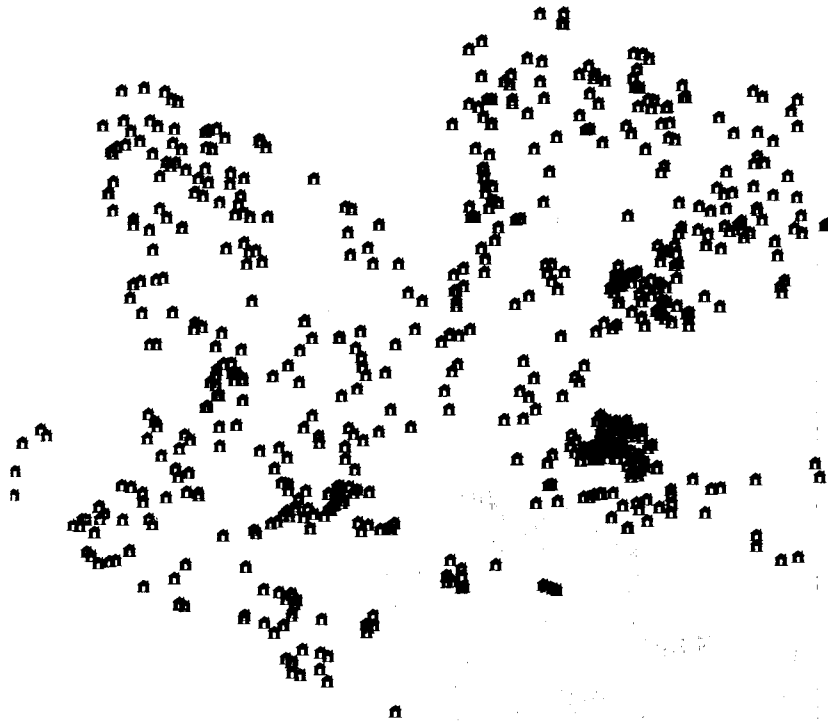
Baltimore

Census Tract Dot-Density Theme

- = Delinquencies on Loans Originated between 1987 and 1997

SOURCE: U.S. HUD

NTIC National Training and Information Center
810 N. Milwaukee Ave. □ Chicago, Illinois 60622-4103 □ (312) 243-3035
**Single Family Homes in HUD's Inventory as
of August 23, 1999**



**A Total of 675
Properties in
Baltimore**

[From City Limits, November 1999]

THE HARLEM SHUFFLE

(By Kemba Johnson)

After spending the last two decades buying and fixing up houses for Long Islanders, Larry Nelson decided this spring that it was time to get into the nonprofit housing business. Launching the Alliance for Individualized Ministries (AIM) and signing up for a federal loan program for rehabbing old dilapidated buildings, Nelson thought only of creating cheap, decent housing for poor families in and around Hempstead. He never imagined he'd be making someone else rich.

Then a contractor friend told him that he knew some people who could help Nelson become a nonprofit development expert. There was just one catch: Nelson would have to go a little farther afield—to Harlem and Brooklyn, in fact. "They told me there were brownstones that I could pick up and help people get affordable housing," Nelson recalls.

Within the month, a real estate lawyer named Andrew Graynor had set Nelson up with a mortgage company in Farmingdale, Long Island, and a real estate appraiser in Melville. The contractor friend also introduced Nelson to one of Graynor's clients, a real estate investor named Howard Finger, who found 10 brownstones for him to buy in Upper Manhattan and Brooklyn. Nelson says Graynor even gave him \$5,000 per property to cover business expenses. For Nelson, the deal sounded great: He would buy the buildings, rehab them immediately, and transfer the mortgage to new buyers soon after.

But he soon found out that Graynor's generosity wasn't quite what he bargained for. In fact, it came at a high price: hundreds of thousands of dollars. That's the profit that Finger's real estate company, No Exit Place Realty Corp., made when it sold Nelson the buildings. No Exit Place bought each townhouse cheaply, passing it on to Nelson within a day or two at a substantial markup. In August No Exit Place bought 52 West 126 Street for \$130,000, then sold it to Nelson the next day for \$262,000. In another transaction, 66 West 126th Street, the realty paid \$130,000 and sold it the same day to Nelson for \$206,000. (All sale prices in this story are calculated based on property transfer taxes.) So each time he bought a building, Nelson was on the receiving end of someone else's property flip—and each time, he paid handsomely for the privilege.

All the elements of the deal, from loan to realty company to appraiser to mortgage lender, fit together neatly. Nelson was getting his buildings through insured loans backed by the Federal Housing Administration, courtesy of a unique program that combines both purchase price and rehab costs into one insured mortgage. In consultation with the appraiser, the mortgage company approved loans large enough to meet No Exit Place's steep asking prices, even though the buildings needed extensive work and had been on the market for much less just days before.

Nelson soon figured out that it wasn't such a great deal after all. "As a nonprofit organization I really lost money when I should have gone to the seller and not used the middleman," Nelson says ruefully. "It's totally legal, but it just didn't sit right. There was a lot of money to be made." By May, Nelson was fed up with No Exit Place, Graynor and the contractor friend who started it all. He decided to get out of the deal, demanding that they sell off the properties for him immediately.

"We sell property at a fair market value," Finger responds. "Right now market value is \$250,000 and \$260,000, and I sometimes sell under fair market value."

Graynor, too, says that his real estate clients sell within the going market rate—they just happen to find great deals when they buy property. "[Nelson] may not be getting the same deal that my client got. That is the nature of real estate investment," Graynor says. "No one is forcing them to buy." Asked whether he recalls providing \$50,000 to Nelson, Graynor responds, "I honestly do not know."

As a former businessman, Nelson isn't opposed to realtors earning healthy profits—it's just that markups of up to 100 percent are a bit more than healthy. His goal was to build affordable housing, but buying these buildings at pumped-up prices meant that his buyers would have to assume high mortgages. The last thing Nelson wanted to be doing in Harlem and Brooklyn was creating housing that residents couldn't afford, and this deal made him feel like a conduit between realtors and obscene profits. "[These profits] should be channeled to people who need affordable housing, not lining their pockets," he complains. "In this case, AIM doesn't walk away a winner. I walk away a supplier."

In this case, what turned Nelson from a developer into a supplier was FHA's 203(k) loan program. The program, designed to promote home ownership for poor and middle-income people, is set up to help individuals and certain pre-approved

nonprofits afford the risky, expensive project of rehabbing old housing. With the U.S. Department of Housing and Urban Development insuring the loans, the program makes mortgages easier to get in neighborhoods where that's not always simple. It has exploded in recent years: In the New York area, there are nearly 10 times as many 203(k) loans today as there were three years ago.

But for real estate operators, 203(k) has also been easy pickings. In 1998, three Brooklyn-based nonprofits enrolled in the loan program discovered that they had been burned by their mortgage companies, which promised them one-stop housing rehabs but instead hooked them up with overpriced buildings and shoddy construction. Left holding uninhabitable housing and high mortgages they can't pay, the nonprofits are now in the process of defaulting on 300 properties and \$60 million in loans. HUD has launched an investigation into the deals.

Meanwhile, three other out-of-town nonprofits in the program, Family Preservation Center, Word of Life Ministries, and St. Stephen's Baptist Church, are still fixing up dozens of Harlem buildings. With every building, Graynor's realty clients paid tiny sums ranging from \$20,000 to \$165,000, and the nonprofits paid much higher prices days or weeks later—up to \$365,000. "They have a nice little network going," Nelson says. "What they did to me, they're doing to the next nonprofit and ones after that."

Three years ago, HUD banned for-profit investors from this program, citing problems with profiteering and corruption. Now, *City Limits* has learned, for-profit interests are once again profiting mightily from 203(k). The result: overpriced properties in poor neighborhoods, quick-flip speculation, and, in Brooklyn, a chain of expensive defaults. "This is so big and such a mess, it'll take [HUD] years to figure this out," says a HUD official close to the Brooklyn investigation. "By that time there will be so many [nonprofits] in default."

In the process, a HUD program that is supposed to bring new affordable housing to neighborhoods like Harlem and Bed-Stuy has so far primarily made money for the middlemen. Nonprofits that know little about housing get sucked into expensive, complex and risky rehab projects. The loan program has allowed outsiders to cash in, jacking up housing prices and producing \$400,000 brownstones and \$1,000 rentals that few neighborhood residents can afford. The 203(k) program is supposed to bolster home ownership. Instead, the invasion of the Long Island realties, backed with government money, is pushing housing out of reach—and turning Harlem into a cash machine.

The federal housing program that made all this possible was devised to plug a hole in the housing finance market, one that makes it hard to renovate old buildings in poor and moderate-income areas. Generally, a developer who wants to buy and fix up a decrepit building has to get two loans: one for the purchase and one for its rehabilitation. But banks are often reluctant to make a double loan on a building that needs a lot of work, especially in neighborhoods like Harlem, explains Matthew Lee, executive director of the Bronx finance industry watchdog Inner City Press. Says Lee, "The bank thinks, 'What do we get if you don't pay—a run-down house?'"

So 203(k) essentially works like an insurance fund, making bankers feel more comfortable with these risky loans by putting a government promise behind their cash. Under the program, banks and mortgage companies hand out purchase and rehab loans in one mortgage package of up to about \$400,000. Construction must be completed within six months, which is also when the first mortgage payments come due. From a bank's point of view, the greatest virtue of the program is that if a buyer defaults, the lender gets paid back in full—including costs—from an FHA insurance fund.

The program has been around since 1961, but only recently has it caught on. Nationwide, the program grew from an average of 3,000 loans in the early 1990s to 17,000 in 1996 alone. Locally, it has exploded. In New York City, Westchester, Long Island and Rockland County, there were 134 loans in 1996. Last year, there were 1,128. It will probably get bigger. HUD has been pushing the program with a national promotion tour.

But as early as 1996, HUD's auditors found that the program is "highly vulnerable to waste, fraud and abuse by investors and nonprofit borrowers." HUD researchers studied 203(k) loan records from seven states and found abuses in every one of them. Lenders failed to make sure rehab work was completed. Appraisers overpriced property. Nonprofits got overwhelmed, trying to restore too many homes at once. Some contractors, realtors and agents insisted on unusually high fees.

The auditors concluded that the problem with 203(k) rests in its design, which puts too much responsibility for oversight on lenders. As the program is structured, lenders have little incentive to watch the shop, and plenty of reasons to make lots of loans. First, they make their money through the fees and closing costs they get for each loan completed. Second, they're guaranteed a refund from the federal gov-

ernment if anything goes wrong. Also, the auditors found the program was ripe for abuse by profit-seeking investors, who could make money whether or not the project ultimately succeeded. Spurred by the report, in late 1996 HUD barred for-profit property investors from the 203(k) program, as it already had done with some other FHA loan programs.

But in New York City, for-profit investors have apparently found a way back into the loop. "They have recreated an opportunity for themselves to make a lot of money," charges Ginnie Phillips, executive director of Helpline Soul Rescue Ministries in Crown Heights. Her group is one of the Brooklyn organizations now defaulting on their 203(k) loans. As profiteering players return, New York is now seeing practices alarmingly similar to the abuses HUD described in its report.

Phillips' journey into real estate hell began with a phone call in 1997. Mortgage Lending of America invited Helpline to buy homes in eastern Brooklyn. The organization had just been accepted to HUD's list of approved nonprofits for the 203(k) program, but had done only small-scale housing redevelopment.

Mortgage Lending of America vowed to take care of that, introducing the non-profit to Tri-Metro, a realtor in Ozone Park, Queens, which would buy properties for Helpline and arrange for contractors to rehab them. "They contact the nonprofit and promise to set them up in an affordable housing program," recalls Phillips. To sweeten the deal, Helpline would get \$5,000 in administrative reimbursements from Tri-Metro each time it bought a building with its FHA line of credit. There was just one catch: In the same written agreement with Tri-Metro that guaranteed Helpline the cash, Phillips signed a statement saying she wasn't allowed to see the buildings before or during construction.

The deal was tempting: armchair housing rehab, with a bonus to boot. Besides Helpline, at least two other groups in Brooklyn bought into the idea. Once the realtor selected the houses for purchase, Mortgage Lending of America sent its outside appraiser, CLA Inc., to green-light the sales price and rehab estimates for the buildings—99 of them in all. The longer Helpline worked with the lender and the realtor, the more expensive the homes became, starting at \$70,500 in September 1997 and peaking at \$275,000 at the end of 1998. Subsequently, a UPN 9 News investigation in June found that these buildings appeared overvalued. For one five-unit fixer-upper at 706 Essex Street in Brownsville, the group paid \$275,000; Channel 9 found that the median price for 40 homes sold in the area that year was \$150,000.

For Phillips, agreeing not to see the homes was her biggest mistake—and the detail her realtor relied on. She says Mortgage Lending of America refused to let her see the appraisal records and closing documents, and her request to get a new appraiser was rebuffed. "We were shut out of the process," Phillips says. "We were unhappy and could not get any information."

So in late 1998 Phillips hired her own lawyers and broke her contract with Tri-Metro. When she eventually saw the properties, sagging floors and leaky pipes were recurring motifs. Walls were easily punctured, tubs were not supported by the bathroom floors and a tiled shower wall was easily removed, showing daylight through the cracks. Helpline's independent appraiser and HUD officials who later saw the houses said most of the homes were overappraised—some by as much as 50 percent. Neither Mortgage Lending of America nor CLA returned repeated calls from *City Limits*.

To repair hundreds of such houses would have been extremely costly, so Helpline and the other nonprofits braced for default. A HUD investigation ensued, and an official close to the investigation tells *City Limits* that perhaps only 40 percent of the rehab money went into the property. The rest went to fees and other charges, payable to Tri-Metro and its subcontractors.

Including Helpline's buildings, there are about 300 properties in Brooklyn now defaulting on 203(k) loans. The federal agency is trying to stem the tide: In September, it barred Mortgage Lending of America from the FHA loan program, citing its high default rate—16.8 percent, compared with the 5 percent average for metropolitan area FHA lenders. But the same HUD official, who asked not to be identified, believes there are already many other defaults waiting in the wings. He estimates that by the time HUD repays all these flops, the agency will be out by about \$1 billion.

HUD's insurance fund is supposed to take run-of-the-mill defaults and the occasional scandal in stride. It's replenished with a 0.5 percent annual charge passed on to every 203(k) borrower. But any substantial rash of defaults could ultimately lead to an increase in insurance premiums, says HUD. And nonprofits that use 203(k) have other concerns. "If there are investors using the program under the guise of nonprofits, it could lead HUD to place more restrictions on the nonprofits," says David Beer, director of housing development at Neighborhood Housing Services, which has rehabbed nearly 70 buildings through 203(k).

Since Channel 9's story, another five nonprofits with nearly 200 more properties in New York have reported that they've been stuck with poorly rehabbed properties in 203(k) deals. "Nonprofits usually have been victims because they don't know enough," Phillips laments. "They're literally being exploited until they wake up and are left with buildings they can't sell."

Drew Graynor was able to transform Larry Nelson into a nonprofit developer at a blistering pace. The \$50,000 that Nelson's organization got from Graynor for his 10 properties helped Nelson prove to HUD that his group had emergency cash reserves on hand. "He is the man," Nelson says of Graynor. "He arranged everything, my banks loans and everything. He introduced me to the mortgage company."

But the mortgage company that Graynor brought in, Executive Mortgage Bankers Ltd. in Farmingdale, was no peach. Like Mortgage Lending of America, it appears on the National Training and Information Center's list of the 50 worst lenders in New York City, for one big reason: the company's 11.4 percent loan default rate. Executive Mortgage, in turn, brought in CLA to validate the high asking prices on Howard Finger's 10 buildings. That's the same appraisal company that vouched that Helpline's shabby homes were worth top dollar.

CLA's evaluations were crucial to Nelson's 203(k) deals. In estimating market values, appraisers are supposed to consider the sales prices of comparable nearby properties. If the building in question was itself recently sold, that price also is a key indicator of value. But Finger had paid much less for these properties than he charged Nelson a day or two later, and the high resale prices were all backed up by CLA as the appraiser.

CLA and its owner, Chris Liano, is a common link between Helpline, Nelson and Family Preservation and the other Harlem 203(k) nonprofits. It was Liano's company that okayed the highprofit flips that enabled realities to cash in, charging FHA approved nonprofits far more than the realities paid for each building.

In 203(k), as with most other FHA programs, appraisers are supposed to keep a watchful eye on the mortgage process. Their assessments should ensure that prices don't get out of hand and could keep the resulting projects affordable.

Now, facing hundreds of defaults in Brooklyn, HUD is investigating why New York mortgage lenders have been so generous with its money—and whether their appraisers played a role in overextending the lenders. "This is an issue in New York that we have been looking into—whether or not property was properly appraised," says John Frelich, director of Quality Assurance in the Philadelphia HUD office, which oversees 203(k) for the Northeast. "The concerns are of high intensity within New York. The New York region is a high-volume 203(k) area and a high-volume area for nonprofits."

When contractors showed up one morning last February to start converting the single-room occupancy residence at 58 Edgecombe Avenue, they did what they normally do: turned off the electricity and water, ripped down the doors, and started demolishing the bathrooms. It would have been a typical job if not for one thing: six men lived there. Residents say they were roused from their beds by hammers knocking at their doors around 8 a.m. and summarily thrown out.

Unlike the other tenants, who went off to work, Benny Brown had nothing to do but worry and wait for his Veteran's Assistance check to come in the mail. He spent the rest of the cold winter's day wandering the neighborhood, sitting on a park bench, and ultimately going to the hospital with an anxiety attack. The subway served as his home the next night. A day later, he ended up at a city shelter, where he still lives today.

Brown says that ever since the new owner, Family Preservation, bought the building in November 1998, no one collected his \$300-a-month rent. "They didn't want the money," he says. "They just wanted everybody out."

After the eviction-by-hammer, Family Preservation found itself on the expensive end of several lawsuits. In the first settlement three tenants got \$27,000 each. Brown got \$39,000 a few months ago. Lawyers from the SRO Law Project who represented the tenants were jubilant—illegal eviction cases usually bring a couple thousand dollars, at best. Then the city Department of Housing Preservation and Development piled more liabilities on Family Preservation, winning a court order for \$33,284 in civil penalties and the concession that the building be reinstated as a low-income SRO for at least two years.

How did a nonprofit come to have \$153,284 to pay for one building's worth of mistakes? And just as important, why didn't Family Preservation know people were still living at 58 Edgecombe, which it planned to convert into a four-apartment townhouse?

Sam Stith, Family Preservation's property manager, partly blames himself—but mostly he fingers his realty, a Mineola company called Fix Realty, run by Frank Boccagna. At the time that Family Preservation got into the 203(k) business, it was

a small 3-year-old organization with little experience in housing—most of its work had been in providing case management for mentally retarded children and their families.

Benny Brown got evicted for the simple reason that Stith hadn't yet seen any of the Harlem buildings that Family Preservation had bought, even though the nonprofit had begun buying them in March 1998. "We had no idea. We're a hands-off operation—that was the problem," Stith told City Limits at the time. Fix Realty sold the brownstone to Family Preservation for \$345,000, and, Stith says, the realtors promised that the building was vacant. And Fix Realty also arranged for the gut rehab.

"We trusted other people," says Stith. "Ignorance is no excuse for the law, but we didn't know." As for the money, Stith says his "investors"—whom he refuses to name—paid the settlements and penalties just to make the unfortunate situation go away.

There was something else Fix didn't tell Family Preservation. Two months before the nonprofit bought the building, Fix had acquired it from an estate for \$150,000. This wasn't the only building that Family Preservation bought from Fix. On September 17, Fix bought 355 Pleasant Avenue for \$165,000; the next day it sold the property to Family Preservation for \$310,000. On October 1, Fix bought 51 Bradhurst Avenue for \$27,000, selling it to Family Preservation the next day for \$215,000. Each building was in need of a gut rehab.

The same players reappear in all of Family Preservation's deals. Mortgage Lending of America set up the nonprofit with 203(k) loans. CLA appraised the properties, allowing the mortgage company to approve loans at or near the maximum allowed by FHA at the time. Fix Realty's law firm was also the same one Nelson had dealt with in his 203(k) loans: Graynor & Graynor, on Mineola Boulevard in Mineola, Long Island.

During 1998, Family Preservation ended up buying at least a dozen Harlem properties using FHA loans, from 10 different sellers. Seven of these sellers—including Knarf Realty, Cazzo Realty, Ring Realty, Marfra Management and NMAD Realty—are clients of Graynor & Graynor.

In more than a dozen cases that can be documented with real estate records, these buildings were flipped: bought by realtors and then sold within days at much higher prices to Family Preservation. One transaction was an impressive double flip: 34 West 126th Street was bought by 1 Exit Place Realty—which shares its address with No Exit Place—on May 7, for \$88,000; 1 Exit Place sold it to Cazzo on June 18 for \$135,000; and on June 19 Cazzo sold it to Family Preservation for \$250,000. In every case, Family Preservation took out its loans from Mortgage Lending of America.

Meanwhile, Fix, Knarf (which is also run by Boccagna) and Cazzo were flipping Harlem properties to two other nonprofits, St. Stephen's Baptist Church and Word of Life Ministries of Freeport, Long Island. In six cases that can be documented, the transactions told the same story: Mortgage Lending of America handed out loans for buildings that had doubled in price overnight. For example, in June 1998 St. Stephen's bought 57 West 119th Street for \$215,000 from Knarf. The realtors had paid \$85,000 for it one day earlier. Cazzo Realty bought a widow's brownstone at 336 West 145th Street for \$20,000 in April, selling it to Word of Life a week later for \$225,000.

But Stith says it's not a problem that his nonprofit paid these big markups. He suggests it's part of the cost of doing business. Let's say there's a building on the market for \$90,000, he proposes. "If an investor pays [to buy it], whether out of his pocket or through a loan, and he sells it for \$200,000, and it becomes housing, it's a win-win situation."

Stith acknowledges that "we overpaid for some buildings" but says that his brownstones will ultimately be worth \$400,000. Once the work is finished, Family Preservation expects to rent its apartments out for \$700 to \$1,000 a month, earning stable income for years to come. "You can make a profit out of the rent, hold onto it for five to six years," Stith says.

But the bills are already coming due. It's been more than six months since Family Preservation bought the properties, and the organization now owes mortgage payments to banks even though its buildings are still undergoing reconstruction. Stith isn't worried about that, either. He reports that his "investors" are covering the mortgage payments. And Mortgage Lending of America doesn't have to worry about the payments—like most smaller lenders, the company quickly sold the loans to bigger banks for an immediate return on the investment passing along FHA's insurance guarantees with the loans.

Family Preservation's business strategy doesn't make sense to Martin Hayott, a longtime Harlem resident who has traded in brownstones for many years. When one

of his run-down holdings, 166 West 123rd Street had become “more headache than pleasure,” he unloaded his albatross on Knarf Realty in August at what he thought was a good price, \$60,000. Knarf sold it to Family Preservation a day later for \$250,000, making \$190,000 instantly. Family Preservation’s FHA loan amounted to \$327,400, leaving just \$77,400 for gut-rehab work.

Hayott isn’t mad about the deal—just puzzled. By his reckoning, it would cost at least \$200,000 to make the place livable. On that block, with other vacant buildings nearby, the investment seemed like a bad idea to him. “Who would even spend \$250,000 on that particular street and this particular time?” he asks. “Whoever bought that building will never make that money back in their lifetime.”

Harlem’s other nonprofit housing developers, including the formidable Abyssinian Development Corporation, also scoff at the notion of paying \$200,000 for a dilapidated brownstone. With that kind of price tag, and another \$200,000, they estimate, for a gut-rehab, the finished product would be far too expensive to either sell or rent affordably. Developers and brokers say a more reasonable price for a brownstone in need of gut rehab in early 1998 was about \$150,000. But when Family Preservation’s shopping trip began around that time, it was paying an average of \$256,000 a pop. Given FHA loan restrictions, that left the organization with an average of \$58,500 per property for a complete rehab job—framing, wiring, plumbing and all.

Stith refuses to say how much his organization is spending on each rehab, or how he intends to meet any cash shortfalls. “I know we’re going to make [the money] back,” Stith insists. “I’ve done the numbers. That’s not even a problem.”

As it recognizes that 203(k) has become a feeding trough, HUD has just recently begun to do something about it. In June, its investigators started snooping around New York, looking into the mechanics of loans and appraisals and inspecting how much money has been set aside for rehab, how long rehabs have taken and how contractors were paid.

That same month, the agency unleashed a set of reforms aimed at cracking down on problem appraisers. Under new rules, appraisers must assess 80 specific features in each property, taking some of the subjectivity out of the process. HUD will retest all its appraisers, subjecting them to spot reviews in the field, and they now face stiffer penalties for infractions. Finally, a new computerized monitoring system will reg-flag suspicious loans and appraisals.

Lenders are also coming under scrutiny. Under HUD’s new “credit watch,” lenders with three times the FHA default for a region will face getting suspended or barred from the program. Already, 33 lenders, including Mortgage Lending of America, were barred in late September from making FHA loans.

Perhaps most important, the agency released a new proposed rule in September that would prohibit realty companies that sell to nonprofits from giving them money in connection with those sales, like the fees paid to Helpline and AIM. “We don’t want sellers to induce nonprofits to buy properties [from them] by giving them the down payment” explains Brenda LaRoche, director of processing and underwriting in HUD’s Philadelphia office.

In part, the measures simply reinstate old safety checks that HUD had abandoned. The agency used to prevent collusion by insisting on a blind appraisal process, where appraisers were selected at random to review prospective FHA loan purchases. That policy was revoked in 1994.

And the measures don’t necessarily go to the heart of the problem with 203(k): that the foxes are guarding the henhouse. HUD uses spot reviews to inspect about one in 10 loans for improprieties nationwide. But it’s the mortgage lenders that are entrusted to check nonprofits and individuals for credit-worthiness, ensure that the construction work is completed, and choose reputable appraisers. Under the new reforms, that won’t change. From the agency’s point of view, looking over everyone’s shoulder—from lender to contractor is just too expensive.

But FHA has already seen how quickly rampant abuse can crush the sweet dream of homeownership. During the late 1960s and early ’70s HUD was hit by a rash of scams connected to its Section 235 loan program, through which the agency subsidized mortgage payments and, as it does now with 203(k), insured lenders against default. Those vulnerabilities led to many of the same problems now racking 203(k), including overappraised property and shoddy construction. Poor New Yorkers and low-income home-buyers in cities across the nation abandoned their homes in droves. Fully 18 percent of the homes ended up in default; in Sunset Park alone 100 houses sat vacant. By 1973 the program was pulled.

HUD would do well to heed the lessons it learned then. Strict oversight is expensive-but so are the alternatives.

[From The Chicago Sun-Times, September 11, 1998]

FHA BLOCKS FORECLOSURES ON 100 REHABBED HOMES

(By Leon Pitt)

A six-month moratorium is being imposed on foreclosures of homes purchased with federally insured mortgages from a Northwest Side real estate broker accused of shoddy repairs.

Ira Peppercorn, deputy general secretary of the U.S. Housing and Urban Development Department, announced the moratorium Thursday at an Austin neighborhood meeting.

The suspension affects 100 homes in the Austin and West Humboldt Park neighborhoods purchased between 1992 and 1996 through Easy Life Real Estate, housing activists say.

A class-action lawsuit is pending against Easy Life, 4101 W. North, alleging the company knowingly sold shoddily repaired homes to first-time buyers at above market prices.

Peppercorn, HUD's second-in-command, told about 200 people at the neighborhood meeting about the suspension of foreclosures. At the gathering, some owners of Federal Housing Administration-insured homes cited a litany of structural and systems faults they said had been hidden from them.

To help stave off additional foreclosures, Peppercorn said a housing specialist would be assigned to Chicago to work with homeowners in default to try to restructure their loans.

During the moratorium, no homeowner who bought through Easy Life will lose his or her property because of failure to pay the mortgage.

Peppercorn said HUD would also reopen an investigation into Easy Life, as well as the practices of appraisers and lenders of the 100 percent FHA-backed mortgages nationwide. He promised to return to Chicago Oct. 2 for a meeting with a Humboldt Park community organization.

Easy Life officials could not be reached for comment Thursday night.

Before the meeting at Circle Christian Ministries, 118 N. Central, Donald Brown said he bought a supposedly rehabbed two-flat home that had been burned out in the 1000 block of North Parkside Avenue. "I was told I was getting a good deal."

Brown, who said he "fortunately is not in default" on his FHA-backed loan, said "there was nothing good about the deal I got. I have to pay a \$1,200 a month mortgage and constantly shell out to fix stuff and have not yet earned any equity."

Burned siding was painted over, warped and rotting floors were covered with carpets and uneven walls left gaping holes at the joints, Brown said.

Betty Raper, whose son bought a home in the 4800 block of West Race in 1992, said instead of being a dream house, it's been a "nightmare ever since" because the roof leaks and the plumbing and electrical systems are faulty.

CONTIMORTGAGE CORP.

To: _____, _____ S Lakewood Ave., Baltimore, MD 21224

Property Owners:

Canton, Highlandtown, Eastern Avenue

RE: MORTGAGE REDUCTION NOTIFICATION: Neighborhood Housing Service:
ID 5630871-H-3-00

DEAR WILLIAM: Due to the recent increase in real estate value of homes in your area our records indicate that your account: Neighborhood Housing Service: ID 5630871-H-3-00 may now qualify for a new mortgage reduction programs and low interest home improvement loans. Pre-approved, with the authorized financial institution can be completed normally within 72 hours.

In conjunction with the redevelopment efforts of the Patterson Park Communities, free property evaluations and financial restructuring concepts will be offered to property owners FREE during the months of March and April 2000. This information will contribute to maximizing the benefits of the new Home Value Guarantee now offered to qualified homeowners.

Due to the number of inquiries generated by the current lower rates available, No Second Notice will be Issued to Property Owners Concerning this Program. It will be each property owner's responsibility to guarantee that they have been notified of the lowest rates available for their mortgage.

Your account has been assigned to Hal Weiss, our senior account executive for the Patterson Park Redevelopment Project. Please contact him at your earliest conven-

ience to review the financial options now available. Mr. Weiss can be reached at his office Monday through Friday at 410-339-6718.

Sincerely,

ASHLYN HOOD,
Program Director, ContiMortgage Corp.

Senator MIKULSKI. And we are going to ask for your recommendations. Excellent panel. That letter will be included in the record. Thank you for that. And I am also going to ask if you give us snapshots of the presentation. That is just shocking. Instead of a dream, it is despair.

Now, let us turn to Norma Washington, from ACORN. We welcome you, Ms. Washington.

STATEMENT OF NORMA WASHINGTON, PRESIDENT, MARYLAND CHAPTER, ACORN

Ms. WASHINGTON. Thank you. My name is Norma Washington. I am President of the Maryland Chapter of ACORN. I was going to read a prepared statement, but I think I am going to let one of my members tell her story instead. Because the impact of this is going in a lot of different directions. I am going to let you hear her story, because this has gotten to the point where her children are being threatened with being taken from her because of this kind of stuff.

Senator MIKULSKI. Ms. Washington, may we have your prepared statement?

Ms. WASHINGTON. You sure can.
[The statement follows:]

PREPARED STATEMENT OF NORMA WASHINGTON

Good Morning. My name is Norma Washington, I am the President of Maryland ACORN.

There are many reasons ACORN has been involved in fighting real estate flipping and predatory lending. It started when we investigated all the vacant houses in our neighborhoods. In just a 10 square block area in the Walbrook section of Baltimore where I live, we found over 200 vacant houses. And guess who owns many of these vacant houses? ... Mortgage lenders.

So we asked: "Why do these lenders own so many vacant houses that should be filled with families instead of drug dealers?" We looked for people with loans from these lenders and found that the costs and terms of their loans were so outrageous, that foreclosure is a foregone conclusion.

We've talked to hundreds of homeowners in poor and minority communities in Baltimore and their stories show a consistent pattern of families without access to decent credit who are trapped in high-fee, high-interest rate loans. And these loans are devastating our neighborhoods.

Many of these victims, while going through foreclosure, have joined ACORN to fight predatory lending. They want to see major reforms in how these companies do business.

While the problems of real-estate flipping and predatory lending are industry-wide, FHA must do its part by not working with lenders and appraisers that exploit vulnerable families either inside or outside of the FHA program. I call your attention to our written testimony, which includes stories from victims of predatory lenders that are participating in FHA.

In recent years, HUD has taken many steps to address abuses by FHA lenders. These efforts need to be closely monitored and, in many cases, strengthened to ensure the greatest impact. On some issues, HUD may need additional authority from Congress.

The most central improvement needed in the FHA program is to change FHA participation from being a right enjoyed by any lender to a privilege that lenders must earn by meeting established standards. HUD's Credit Watch program moves towards this goal by cutting off lenders with extremely high loan default and claim rates but these standards should become more stringent. Also, while HUD should

continue to review complaints about lenders, it should increase the number of regular reviews it conducts of FHA lenders.

To ensure HUD's reviews accomplish their intended goals, the Mortgage Review Board process, which disciplines noncompliant lenders, needs to be more effective. The current process results in endless delays before the Board can enforce any penalties, and the penalties often amount to a slap on the wrist.

Many families have also suffered because they received inflated appraisals on FHA-insured loans. Congress needs to examine FHA's appraisal reforms, which include better reporting of appraisal information to FHA and to FHA borrowers. Efforts to improve the identification and monitoring of poorly performing appraisers should also be examined.

Finally, the repeated horror stories of families being stripped of their wealth and forced into foreclosure, point to the dire need for strong consumer protections in the home loan market. Those stories reflect on the gross inadequacy of the federal Home Ownership Equity Protection Act, or HOEPA (hope-ah), a half-measure passed in 1994 in response to predatory lending abuses. New legislative proposals to protect consumers are circulating on Capitol Hill, and we need our Maryland Senators, both Senator Sarbanes and Senator Mikulski, to become more active in the fight against predatory lending.

I'll now turn it over to Matilda Wonson, who received an FHA loan, to tell of her experiences.

ACORN has long documented the absence of traditional lenders in lower-income and minority communities and fought to make loans available in those areas. In recent years, however, a new variation on this problem has emerged; to fill the void left by redlining, a new breed of subprime lenders is aggressively marketing high cost loans. Too often, instead of helping homeowners build equity, these lenders, charging high rates and fees and sometimes engaging in outright fraud, are stripping families and communities of the equity in their homes. In our research on home mortgage data, we have found that subprime lenders target the people least able to afford these loans—the residents of lower-income and minority communities.

Through community outreach, Baltimore ACORN has found over 50 victims of predatory lending. Most of these people were victims of either real estate flipping where homes were grossly overvalued to produce high profits for brokers and lenders or home improvement scams where service were never provided or grossly overpriced. The enabling loans occurred both on FHA and VA loans and on conventional loans. For FHA and VA-insured loans, the losers are the borrowers the insured loans were designed to help and often the insurance funds themselves. Bloated appraisals and prepayment penalties prevent borrowers from refinancing their loan to a lower rate or borrowing on equity to make needed repairs. Lenders are more likely to make risky loans since they are insured. As a result, foreclosures have skyrocketed and our neighborhoods are filled with vacant houses, compounding current blight problems.

Unfortunately, the problems of predatory lending have only been brought to light by the widespread devastation caused by real estate flipping in Baltimore. While the business practices of realtors and appraisers in real estate flipping need to be addressed, solutions at the federal level need to be found both inside and outside of the FHA and VA loan programs.

WHAT IS SUBPRIME OR PREDATORY LENDING?

Lenders grade prospective borrowers based on their perceived credit-worthiness, with the perfect credit candidate receiving a grade A credit rating and people in bankruptcy receiving a D rating. Anyone receiving a credit rating of A– or below is considered a subprime applicant. Credit ratings are developed from a borrower's credit history, primarily drawn from reports from the major credit bureaus (such as Equifax) and typically assign each applicant a specific credit score. Financial institutions use these credit scores to determine whether or not they will make a loan, and at what interest rate.

Although credit scoring systems are cloaked in objectivity, the systems have their own biases, which result in substantial inequities. One of the most critical problems is that a credit score is based on each individual's past history of repaying loans. But if your neighborhood does not have any banks offering reasonably-priced loans or you have been the victim of past discrimination by banks on their loan decisions, you have not had the same opportunities to build up a positive credit history as applicants in other neighborhoods or with different characteristics. If you have only loans had access to high-cost loans regardless of your credit-worthiness, you will naturally have been more likely to default on those loans than someone with access to reasonably-priced loans, giving you a lower credit score. Most credit scoring sys-

tems produce the same effect by weighing past repayment of a prime loan much higher than past repayment of a subprime loan.

In addition, the credit reports on which scores are based often have errors and omissions, and these occur more frequently in the case of lower-income applicants. Because credit scoring systems are proprietary, we can not know what their criteria are. Our experience suggests that the systems contain hidden biases resulting in scores which reflect an applicant's resemblance to a typical middle class model more than their actual credit worthiness.

Even more dramatically, while some borrowers in the subprime market are genuine credit risks, there is overwhelming evidence that many lower-income and minority borrowers have been pushed into this market only because lenders are not offering them prime loans. Instead, lenders see an opportunity to make more money by charging higher rates and fees. Recent studies by Freddie Mac and Standard & Poor's have found that from 20 to 30 percent of borrowers who receive subprime mortgages could have qualified for a traditional mortgage at the lower rate offered by banks to A borrowers. ACORN's experience suggests that with the assistance of a moderate amount of loan and credit counseling, the portion of borrowers who qualify for A loans would be much larger.

THE GROWTH IN SUBPRIME LENDING

Recent studies on mortgage lending by ACORN and the Urban Institute have found continuing, and in some respects even increasing, disparities in the availability of prime conventional loans to white and minority applicants. Despite low interest rates in recent years, the lending gap to African-Americans and Latinos has not narrowed. Where minorities and lower-income families are shut out of mainstream lending, predatory lenders have stepped in to capitalize on lower-income and minority families and their unmet need for capital.

Subprime lending is growing at a remarkable rate. According to a HUD working paper, subprime lenders increased their share of conventional loan applications from 1.4 percent of all conventional loans in 1983 to 10.2 percent in 1998. Subprime loans for home purchases increased by 56.3 percent from 1993 to 1998, compared to an increase of only 16.4 percent for conventional products. Inside Mortgage Finance estimates that subprime mortgage originations amounted to \$150 billion in 1998, up from \$125 billion in 1997. Subprime lending overall, including home equity and refinancing as well as purchase loans, has grown even faster. Every year since 1993 has seen annual growth of more than 40 percent in total subprime loan originations.

Banks and other A lenders bear responsibility for the spread of subprime lending by virtue of their continued redlining of lower-income and minority neighborhoods. In many cases the connections are even closer. The same banks that are failing to meet the demand for prime loans in lower income and minority communities own half of the country's largest subprime lenders, which are targeting those same neighborhoods. Some subprime lenders, like Norwest Funding, share a name with their parent bank; for others like Citigroup's Commercial Credit, the connection is less immediately evident. A less direct, but still crucial, link between banks and predatory lending is through the securitization of subprime loans by banks, which provides the financing that makes expansion of subprime lending possible.

PREDATORY LENDING PRACTICES

Subprime lenders have become predators by charging interest rates unrelated to risk to communities that are desperate for access to credit, as well as by loading on additional fees and other costs. Calls to various subprime lenders confirm that their best interest rates are at least 9.5 percent for 'perfect credit' although most people receive still higher rates. For example, IMC Mortgage self-reports that over 50 percent of their loans were originated to people with grade A credit and that these A credit borrowers received an average interest rate of 9.9 percent. These higher interest rates represent a significant drain on lower-income families and communities; the chart below illustrates the impact of these interest rates on the total cost of the loan based on an average subprime interest rate of 10.5 percent.

	Total cost	Total cost
Loan Amount ¹	\$50,000	\$100,000
Monthly and	367/mo.	734/mo.
Total Payments at Prime 8 percent	132,000	264,000
Monthly and	457/mo.	915/mo.
Total Payments at Predatory Rate 10.5 percent	165,000	329,000

	Total cost	Total cost
Difference in Monthly and Total Payments Over 30 Years	33,000	65,000

¹ Based on a 30-year loan with values rounded to the nearest thousand.

Predatory lenders also take more money up front by charging high closing costs. Such costs may include charging duplicate fees, inflated broker fees, fees that lack a clear description, costs that have no relationship to services being performed, and higher than actual fees to record the loan to the county land records office. Often, closing costs (which are more comprehensive than origination fees, which set the HOEPA fee threshold) run up to 8 percent–15 percent of the loan amount, significantly higher than the average of 3 percent–5 percent for the same work performed at bank closings.

Many predatory lenders cash in on closing fees by repeated refinancing of loans, a practice often called ‘Flipping.’ Each time a loan is refinanced, closing costs are again imposed and often financed into the loan.

Predatory lenders often also extend high loan-to-value (LTV) loans, including loans for more than the value of the house used as collateral. These loans are risky because the collateral does not cover the loan in the event of default. Perhaps even more damaging, loans with LTVs above 100 percent leave the borrower spending years paying off the additional funds without developing any equity in their home.

Balloon loans, which are structured to include an extremely high final payment, are another frequent ploy of predatory lenders. On these loans, the borrower makes monthly payments that cover the interest on the loan but very little of the principal. After paying off the loan for many—often fifteen—years they owe a final large balloon payment only slightly below the original loan amount. Often, borrowers are unaware of these final payments or of their significance.

ROLE OF GOVERNMENT INSURED LOANS

Community reinvestment patterns reveal a “decline to subprime.” As stated previously, banks are failing to provide affordable loans in lower-income and minority communities. FHA and VA lenders have been more willing to originate government-insured loans in these communities. Unfortunately, many of these loans are being made in violation of program guidelines. We have found FHA loans with faulty appraisals, extended debt ratios, fraudulent applications, and high interest rates. Sadly, these lenders market these loans as their best product. Appendix A includes a sampling of victims who have received predatory loans from FHA approved lenders.

CONCLUSION

We are a nation with two separate and very unequal financial systems—one for the rich and another for the poor, one for whites and another for minorities. This system has a devastating impact on inner-city communities as redlining and discrimination continue to be pervasive. While the lack of access to lower-cost credit costs neighborhoods hundreds of thousands of dollars each year, it also opens the door for abuse and scandal by mortgage companies, as documented by groups like ACORN and the media. Rather than strengthen neighborhoods by providing access to credit, predatory lenders have contributed to further deterioration of lower-income and minority communities by stripping homeowners of their equity and charging exorbitant interest rates leading to foreclosures and vacant houses.

ACORN RECOMMENDATIONS

HUD’s Mortgagee Review Board process, which disciplines non-compliant FHA lenders, needs to be more effective. They need to expand criteria to suspend FHA lenders beyond high default and claim rates. Even these rates should have lower levels than the current Credit Watch program standards.

Congress needs to examine FHA’s appraisal reforms to ensure they are effective in improving reporting by appraiser’s to the FHA program and to borrowers. Efforts to improve the identification and monitoring of poorly performing appraisers should also be examined.

All lenders which engage in subprime lending should pledge adherence to a meaningful “Code of Conduct” that includes: fair pricing; full and understandable disclosures of loan costs, terms, and conditions; a loan review system that rejects fraudulent or discriminatory loans; making no loans which clearly exceed a borrower’s ability to repay; and refraining from charging fees which bear no relation to the costs of the services performed.

These lenders should review their loan portfolios and compensate borrowers whose loans clearly violate this code.

Subprime lenders should develop products which allow borrowers with a consistent record of on-time payments to move to lower interest rates.

Lenders which offer prime as well as subprime products should increase their outreach and loan volume in underserved communities for their prime loan products. Lenders must establish uniform pricing and underwriting guidelines for all of their lending subsidiaries, and for all of the communities in which they do business.

Federal and State law should be expanded to establish minimum standards which protect borrowers from deceptive or discriminatory loans. This includes strengthening current disclosure laws: the Truth in Lending Act (TILA), the Real Estate Settlement Procedures Act (RESPA), and the Home Owner Equity Protection Act (HOEPA).

Federal and state regulators should increase their scrutiny of predatory lending practices, including examining the interest rates and other loan costs along with the distribution of high cost loans.

Regulators must require HMDA reporting by all lenders that make purchase, refinance, home equity and home improvement loans. Regulators should also collect data on foreclosures by lender and make it available for public scrutiny.

Lenders and local governments should fund and expand programs to provide basic information about lending and enable people to protect themselves from predatory practices by expanding loan counseling and home buyer education programs which assist minority and lower-income families.

Federal, state, and local authorities should devote the necessary resources to investigating and prosecuting lending abuses.

ACORN is the nation's oldest and largest grassroots community organization. In the past decade, ACORN has waged campaigns against bank redlining and discrimination, worked to increase access to credit for low-income and minority neighborhoods, and fought for greater community reinvestment by financial institutions. We have won local and national lending agreements with banks that have increased the flexibility of their underwriting guidelines and developed loan products that better meet the credit needs of low-income communities.

APPENDIX A.—FHA AND GSE APPROVED PREDATORY LENDERS

A SAMPLING OF BORROWER STORIES COLLECTED BY ACORN—MARCH 27, 2000

Borrower stories from the following FHA lenders: American Mortgage Reduction; American SkyCorp; Associates; Bankers First Mortgage; Creative Mortgage & Equity; Gelt Financial; Golden National; New Century Mortgage and WMC.

Borrower stories from the following FNMA approved lenders: Associates; WMC.

Borrower stories included from the following lenders who sold loans to FNMA, GNMA or FULMC in 1998: Beneficial; Golden National; WMC.

FHA LENDERS

American SkyCorp

Baltimore

Marshall Skinner bought his home in the Patterson Park neighborhood of Baltimore. The price of the house was \$44,800, greatly over-valued for a house where the ceiling is leaking and there are holes in the walls and the floor.

The seller of the house sent Mr. Skinner to American SkyCorp for an FHA loan. There are many troubling items about Skinner's loan documents, beginning with many spaces left blank that should have been filled in. Also the amounts listed on the HUD-1 settlement statement are different from the costs listed on his other closing documents.

The loan application was also falsified. The amounts for his income from Social Security and SSI do not add up to his total income. The loan application also lists \$15,000 in assets from furniture and personal property. However, Skinner didn't own any furniture at the time of application.

Since his closing costs were high, he received a grant from the Empower Baltimore Management Corporation through the Department of Housing and Community Development. On the \$44,800 loan, SkyCorp received over \$4,100—over 9 percent of the loan amount. While Skinner's house needs repairs, he is having trouble locating financing because his loan amount is so large due to the inflated appraisal.

*American Mortgage Reduction**Baltimore*

Deborah Claude bought her house on 810 N. Milton Ave. in February 1996 from Mid Atlantic Realtors. She had been renting the house for 2 years with the option to buy. As she began to frequently need repairs, the realtors pressured her to purchase the house.

She was tired of depending on the landlord to repair things so she agreed to buy the house for \$29,000 with a 10 year loan at 11.15 percent, from Hopkins Federal. The roof started falling in right after she moved in. After one year, Ms. Claude had to do a lot of repairs. This included fixing the plumbing, the furnace, and the electrical wiring.

She went to Advance Remodeling to fix her home. They sent her to American Mortgage Reduction which offered her a 12.35 percent interest rate for a 203k loan. Deborah wanted to shop around for a better rate but the remodeling company told her they would do the repairs only if she went to American Mortgage Reduction.

Ms. Claude refinanced in June 1997 at the 12.35 percent interest rate and also had to pay over \$4,000 in fees—almost 14 percent of the \$29,000 loan. The lender paid her home improvement money directly to the contractors without checking to see if the improvements were done. As a result, the contractors did not complete all the work and Deborah is further in debt.

*Associates**Oakland*

Sonya Centeno has an 11 percent interest rate home purchase mortgage loan with The Associates. She had to pay \$1300 in fees and they made her pay for the previous owner's back taxes and charged her in monthly back payments back to December even though she didn't move in until February. After she made the two payments for December and January, they said she didn't need to and refused to give her money back. They have been encouraging her to refinance. She has been paying \$761 a month for three years and has yet to make any payment on the principal.

Philadelphia

Grace Brumskill, a Philadelphia homeowner, received a notice in the mail from Associates Consumer Discount about a home equity loan. Ms. Brumskill told Associates that she wanted a loan for \$5,000, and they informed her that she had to borrow a minimum of \$10,000. Ms. Brumskill went ahead and took out the loan for \$10,000. Associates charged her 11.5 percent interest, even though her 646 credit score should have gotten her a lower rate (the average rate for a 30-year mortgage was under 8 percent in October 1999 when Ms. Brumskill received her loan). Associates also charged her \$2,066 in fees—21 percent of the \$10,000 she was borrowing. Included in these fees were \$560 for credit life insurance, which, by financing into the loan, will actually cost Ms. Brumskill almost \$900.

*Bankers First Mortgage**Baltimore*

Roberta Taylor is an African-American woman in her early 50s Roberta had been renting her home on Greenmount Avenue for 14 years when her landlord offered to let her buy the house. Although the home needed some repairs, her landlord promised they would be fixed. She received a loan in February 1997 from Banker's First for \$30,300 at 13.651 percent interest with a \$28,594 balloon payment due in 15 years. Her settlement statement says she bought the home for \$43,500 for which she got a loan from Banker's First Mortgage. The settlement statement lists a second mortgage for \$7,010, but her sales contract lists a second loan for \$5,510 at 6 percent interest. The second loan showed interest only payments and the loan was to be forgiven in 5 years.

According to Banker's First, this loan was to cover closing costs. Her loan amount was \$32,625 since she got a renter's credit. The appraised value was \$44,500 and used comparison properties in different neighborhoods than her house. Roberta paid a 1 percent loan origination fee and a 4 percent loan discount on top of \$690 in other fees to Banker's First for a total of \$2,321 paid to Banker's First. The appraisal said her house was worth \$44,500. According to her loan officer, he told her how to improve her credit and to come back to see him in a year to apply for an FHA loan.

Roberta refinanced with Bankers First a year later in April 1998 asking for a lower interest rate. Her loan officer told her that in order to get a lower rate, she needed a balloon note, a co-signer and a prepayment penalty. This time, her house was appraised for \$49,000. (both appraisals were done by Elder Appraisals). Accord-

ing to her settlement statement, she paid 1 origination fee, 5 percent loan discount and \$428 in additional fees for a total of \$2,822 paid to Bankers First and \$5,015 in total closing costs. Her loan amount increased to \$39,900 after adding in the closing costs and her second loan of \$2,000. Her loan officer said he negotiated this second loan down to \$2,000 for her, although he later admitted that the entire second loan would have been forgiven in five years had she continued to pay it.

Baltimore

Eller Guyton is an African-American woman who had been renting from Chase Realty for many years when they offered to sell her the house. She bought the house for \$35,400 in October 1997 with a loan from Banker's First. She received a renter's credit of \$14,714 although her installment contract was dated April 1997 (at \$320/month). She paid a total of \$5307 in fees including a 1 percent loan origination fee, a 5 percent loan discount fee, and \$728 in other fees to Bankers First for a total of \$2,302. Her loan amount was \$26,250 with an interest rate of 13 percent. Eller's income was \$782/month at a minimum wage job and her proposed payments were at \$358. Her application falsely lists her personal belongings as assets worth \$20,000. Her credit report dated October 1997 gives her a credit score of 656.

She refinanced with Bankers First in September 1998 when her loan amount was \$26,902 plus \$6,682 in closing costs, increasing her loan amount to \$35,000. This gave her \$1,414 in cash for medical bills and property taxes. Her closing costs were 7.9 percent loan discount fee, a 1 percent loan origination fee, and \$404 in other fees to Bankers First for a total of \$3,514, which is over 10 percent of her loan amount. Her credit report did not give her a beacon score saying "no qualifying account present" and failed to list her current mortgage.

After a couple of heart attacks, Eller is currently unemployed and in foreclosure.

Baltimore

Harvey Mayo is an elderly African-American man in Baltimore. He was renting his home when he decided to buy it from his landlord, Chase Management. Although Harvey didn't know it, Chase had him sign a land installment contract, which meant he was already buying the house from them. So he got a loan from Bankers First Mortgage Company, which he thought was to buy his home. In fact, it was a refinance loan.

Mr. Mayo's good faith estimate from Banker's First is difficult to understand since the settlement charges printed on the sheet are crossed out, new amounts are written in, and some of those are crossed out. However, notations written on the top of this paper indicate his loan as an "A" grade with a loan to value ratio of 85 percent.

Mr. Mayo's loan was for \$25,800. He paid Banker's First 6 percent of his loan in points to receive a 12.5 percent interest rate. The total amount of money paid to Banker's First was \$2,416, over 9 percent of his loan amount. In addition to these excessive costs, he owes a balloon payment of \$24,652 at the end of 15 years.

On the same day as his closing, Harvey received a notice that Bankers First was already transferring the servicing of his loan. This notice said he would not make any payments to Banker's First but left blank where to send payments to or who would be servicing his loan.

Creative Mortgage & Equity

Chicago

In 1998, Tamar Jordan saw a sign advertising a house for sale in Chicago. She called and was told that house had already been sold but there was another one she could look at. Tamar signed a purchase contract for the house for \$115,000 and later discovered it was only worth \$42,000. The person selling the house arranged for her to get a loan from Creative Mortgage and Equity and Walsh Securities through a complex financial deal. Ms. Jordan put \$5,700 of her own money for the down payment and the seller, with the knowledge of Creative Mortgage, put up almost \$11,700 to make it appear that Mrs. Jordan was making a 15 percent down payment. Although Creative Mortgage and Walsh charged Ms. Jordan \$8,462 in closing costs and fees, no appraisal was provided. Now, Ms. Jordan is stuck with a 10.95 percent interest rate on a mortgage for almost three times the value of her house.

Gelt Financial

Philadelphia

Margaret Thomas, an African-American woman in her sixties, needed money to pay the property taxes and water bill for her home in Philadelphia. She heard about a broker firm, McGlawn and McGlawn, which had gotten a friend of hers a loan.

The brokers came to her house with a representative from Gelt Financial, the loan originator, to have her sign the loan documents. When Ms. Thomas saw how high the interest rate was and what the monthly payment would be, she told them that she wasn't sure she wanted to take the loan after all. They told her that they didn't want her to be frightened, that was just the way loans are, and that she shouldn't worry about it.

After they left, Ms. Thomas continued to have reservations about the loan and called Gelt Financial immediately the next day to revoke the loan. A Gelt employee, Regina Bolger, told Ms. Thomas that the representative she needed to talk to was not in the office. Bolger also told her that she couldn't cancel the loan because she had signed the papers. Ms. Thomas knew that she had three days to revoke the loan and continued to call Gelt. She was unable to get through to the representative who had come to her house. When she asked to speak to Regina Bolger again, she was told that Regina had quit, which Ms. Thomas found out later was not true. Ms. Thomas was stuck with the loan, which Gelt immediately sold to Associates. Ms. Thomas has since lost her job and fallen behind on the payments. Associates has harassed her in violation of the Fair Debt Collection Practices Act, calling her before 8 a.m. and every day of the week, and contacting other family members about her debt.

Golden National

New York

Sheila Small purchased a duplex in Brooklyn, NY with a loan from Golden National. In order to get an 8.5 percent interest rate, Golden National charged her \$10,000 in discount points. They also charged her another \$8,000 in fees because they considered her a high risk. Although Ms. Small only earns \$8,000 a year as a home health aide, someone at Golden National wrote on her application that she made over \$50,000. Before she obtained the loan, she told the representative at Golden National that she had just lost her job. The representative told her not to worry, that the mortgage would still go through.

New Century

Oakland

Margie Washington received a home equity loan one year ago through New Century at 9.58 percent interest. She expected to pay \$700 a month, but her lender, Security National, said that because of her credit she could not get a loan with them. She then sat down with New Century and they gave her an initial low quote (monthly payments and interest) that got her interested. They sent it to an underwriter who said they couldn't go below 9.58 percent. By then she had gone too far and took the loan that was \$20,000 greater than value of her home. She is paying it back at \$1,008/month, more than she can afford, and there is a \$60 fee if any payments are 16 days late.

WMC

Oakland

Helen Vargas is a Latino woman in Oakland who has a loan with WMC that has an interest rate of 19.6 percent. She was quoted costs for a \$12,000 loan but only received \$5,000 after they had her sign a blank piece of paper. She is paying it back at more than she expected to and they have been encouraging her to refinance. She has had to file bankruptcy and may lose her home.

LOANS SOLD TO FNMA, GNMA, FHLMC

Beneficial

Oakland

In 1990, Verderna Tucker contacted a lending company off of a mailing to get a loan for \$15,000 on her home to pay off some back taxes. The lender insisted on an inspector to check her home and told her that foundation work needed because of a recent earthquake meant that she would need a loan for over \$50,000. Next, based upon a mailing she received from Universal that said she could get a loan within 3 weeks, she contacted Universal for a loan of \$7,100 to pay off her taxes. From the first day she met with their agent she realized that she was being preyed upon. They immediately convinced her to include \$7,500 in debt consolidation bringing the loan to \$15,000. They then kept insisting that she take out \$5,000 for pocket money and household bills. She had a deferred loan with the city in the amount of \$15,000 and they wanted her to fold this loan into theirs. She said no but they contacted the City anyway and then told her that the City said they could add it

and subordinate the loan for 30 years. She said no. They did a credit check on her and said that based upon her credit that the lowest rate they could give me was 16.75 percent with additional administrative, appraisal and title search fees of \$6,000, making the loan \$25,000.

Five years later she wanted to lower the payments and started calling around to different companies she had received mail from. Immediately she received a call from the same lending agent who said he heard she was looking for a loan and asked why she hadn't called him earlier. He promised to find a good loan for her and referred her to Beneficial. He recommended that she get an equity line loan with an interest rate of 14 percent on what was a \$36,000 loan. The package she got was a \$20,000 refinance, and numerous other fees such as a \$2,400 administrative fee, a \$2,500 finders fee to the agent—all of which, including the equity line, equaled \$36,000.

A few years later, she received a letter from the courts telling her that somebody from Beneficial was being sentenced for illegal activities. But she has yet to receive any additional information.

She kept getting 2–3 mailings a day from companies offering lower rates. Her payments with Beneficial kept creeping up and up, so she switched the loan to Ameriquest. They consolidated her loans into \$45,000 with a rate of 8.99 percent. She asked them if they were a reliable company to work with—one that wouldn't disappear on her. The loan turned out to be a variable-rate loan that has gone up from 8.9 percent to 12 percent. Before her first payment was due they had already sold the loan to Aurora! She couldn't find where to send her payment in to, and nobody returned her calls.

Three months later Aurora offered her a refinance package at a flat rate of 9.5 percent, with a service charge of \$100. She thought that was great, seeing as most of the service charges she had paid have been much more than that. She has paid over \$10,000 in service fees over the last 9 years, all on an original debt of \$7,100.

Oakland

Martha Thornton Rideout had a loan seven years ago with Beneficial but they didn't tell about the balloon payment that would come due after 5 years. In the 4th year, they gave her a one-year notice of the balloon payment which she could not afford. There was also a \$5,000 prepayment penalty. She was paying her monthly payments but none of it was going to the principal amount of her loan.

APPENDIX B.—DISTRIBUTION OF LOANS MADE BY SUBPRIME LENDERS IN BALTIMORE AND PRINCE GEORGE'S COUNTY TAKEN FROM ACORN'S STUDY "STRIPPING THE WEALTH"

BALTIMORE'S LEADING SUBPRIME LENDERS

We identified the ten subprime lenders who originated the largest number of loans for conventional home purchase, refinancing, and home improvement in the Baltimore Metropolitan Statistical Area (MSA) in 1998. Amresco; Pacific Shore Funding; FHB Funding; Mortgage Lenders Network USA; Commercial Credit; The Money Store; Equicredit; Banc One Financial Services; ContiMortgage and Fidelity Mortgage Decisions.

ALL LOANS

These ten subprime lenders originated 4,277 conventional home purchase, refinance, and home improvement loans in the Baltimore MSA in 1998. Our analysis of these loans found that they were disproportionately made to African-American and low-income borrowers and in minority and low and moderate income neighborhoods.

- African-Americans received a 2.4 times greater percentage of loans made by the top subprime lenders than loans made by all other lenders.
- Low-income borrowers received a 3.6 times greater percentage of loans made by the top subprime lenders than loans made by all other lenders.
- Moderate-income borrowers received a 2.1 times greater percentage of loans made by the top subprime lenders than loans made by all other lenders.
- Low-income neighborhoods received a 6.9 times greater percentage of loans made by the top subprime lenders than loans made by all other lenders.
- Moderate-income neighborhoods received a 3.7 times greater percentage of loans made by the top subprime lenders than loans made by all other lenders.
- Neighborhoods in which minority residents make up between 50 percent and 79 percent of the population received a 3.1 times greater percentage of loans made by the top subprime lenders than they did of loans made by all other lenders.

—Neighborhoods in which minority residents make up between 80 percent and 100 percent of the population received a 6.1 times greater percentage of loans made by the top subprime lenders than they did of loans made by all other lenders.

	All Other Lenders	Subprime Leading Lenders
Percentage of Conventional Purchase, Refinance, and Home Improvement Loans to:		
African-Americans	10.7	26.1
Low-Income Borrowers	6.3	22.8
Moderate-Income Borrowers	13.8	29.0
Low-Income Census Tracts	1.6	10.8
Moderate-Income Census Tracts	8.0	29.5
Census Tracts in which Minorities make up 50–79 percent of Population	3.3	10.3
Census Tracts in which Minorities make up 80–100 percent of Population	4.2	25.8

While the 4,277 loans made by these ten subprime lenders represent only 4 percent of all conventional purchase, refinance, and home improvement loans made in the Baltimore metropolitan area, they constituted a much larger portion of the overall lending to African-Americans and minority neighborhoods.

- The top subprime lenders made 20 percent of all the loans made by Baltimore lenders in census tracts with a minority population between 80 percent and 100 percent.
- The top subprime lenders made at least 9 percent of all the loans made by Baltimore lenders to African-Americans.
- The top subprime lenders made 22 percent of all the loans made by Baltimore lenders in low-income neighborhoods.

HOME IMPROVEMENT AND REFINANCE LOANS

The ten subprime lenders in this study originated 3,809 home improvement and refinance loans in the Baltimore MSA in 1998. The top subprime lenders originated home improvement and refinance loans disproportionately to African-American and low income borrowers and in minority and low-income neighborhoods.

- African-Americans received a 2.2 times greater percentage of loans made by the top subprime lenders than they did of loans made by all other lenders.
- Low-income borrowers received a 3.9 times greater percentage of loans made by the top subprime lenders than they did of loans made by all other lenders.
- Low-income neighborhoods received a 7.2 times greater percentage of loans made by the top subprime lenders than they did of loans made by all other lenders.
- Moderate-income neighborhoods received a 3.5 times greater percentage of loans made by the top subprime lenders than they did of loans made by all other lenders.
- Neighborhoods in which minority residents make up between 50 percent and 79 percent of the population received a 3 times greater percentage of loans made by the top subprime lenders than they did of loans made by all other lenders.
- Neighborhoods in which minority residents make up between 80 percent and 100 percent of the population received a 5.6 times greater percentage of loans made by the top subprime lenders than they did of loans made by all other lenders.

	All Other Lenders	Subprime Leading Lenders
Percentage of Refinance, and Home Improvement Loans to:		
African-Americans	11.3	25.4
Low-Income Borrowers	6.5	23.2
Moderate-Income Borrowers	13.3	30.0
Low-Income Census Tracts	1.3	9.4
Moderate-Income Census Tracts	8.1	28.2

	All Other Lenders	Subprime Leading Lenders
Census Tracts in which Minorities make up 50–79 percent of Population	3.6	10.4
Census Tracts in which Minorities make up 80–100 percent of Population	4.3	24.3

While the 3,809 loans made by these ten subprime lenders represent only 4.7 percent of all refinance and home improvement loans made in the Baltimore metropolitan area, they constituted a much larger portion of the home improvement and refinance lending to African-Americans and low income borrowers and in minority neighborhoods.

- The top subprime lenders made at least 22 percent of the home improvement and refinance loans made by Baltimore lenders in census tracts in which minority residents make up between 80 percent and 100 percent of the population.
- The top subprime lenders made at least 10 percent of the home improvement and refinance loans made by Baltimore lenders to African-Americans.
- The top subprime lenders made at least 26 percent of the home improvement and refinance loans made by Baltimore lenders to low-income neighborhoods and 15 percent of the home improvement and refinance loans made in moderate-income neighborhoods.

CONVENTIONAL PURCHASE MORTGAGES

The top ten subprime lenders in this study originated 337 conventional home purchase mortgages in the Baltimore MSA in 1998. These subprime lenders made their conventional purchase loans disproportionately to African-American and low-income borrowers and in minority and low-income neighborhoods.

- African-Americans received a 4 times greater percentage of conventional loans made by the top subprime lenders than they did of conventional loans made by all other lenders.
- Low-income borrowers received a 3.5 times greater percentage of conventional loans made by the top subprime lenders than they did of conventional loans made by all other lenders.
- Low-income neighborhoods received a 11.6 times greater percentage of conventional loans made by the top subprime lenders than they did of conventional loans made by all other lenders.
- Moderate-income neighborhoods received a 6 times greater percentage of conventional loans made by the top subprime lenders than they did of conventional loans made by all other lenders.
- Neighborhoods in which minority residents make up between 50 percent and 79 percent of the population received a 4.6 times greater percentage of the conventional loans made by the top subprime lenders than they did of conventional loans made by all other lenders.
- Neighborhoods in which minority residents make up between 80 percent and 100 percent of the population received a 11.5 times greater percentage of conventional loans made by the top subprime lenders than they did of conventional loans made by all other lenders.

	All Other Lenders	Subprime Leading Lenders
Percentage of Conventional Home Purchase Loans to:		
African-Americans	8.7	37.1
Low-Income Borrowers	5.8	20.2
Moderate-Income Borrowers	15.3	20.2
Low-Income Census Tracts	2.5	28.5
Moderate-Income Census Tracts	7.9	47.8
Census Tracts in which Minorities make up 50–79 percent of Population	2.3	10.7
Census Tracts in which Minorities make up 80–100 percent of Population	3.9	44.8

While the 337 loans made by these ten subprime lenders represent only 1.3 percent of conventional home purchase mortgages made in the Baltimore metropolitan

area, they constituted a much larger portion of the lending to African-Americans and in minority neighborhoods.

- The top subprime lenders made 13 percent of all the conventional purchase loans made by Baltimore lenders in census tracts in which minorities make up between 80 percent and 100 percent of the population.
- The top subprime lenders made at least 5 percent of all the conventional purchase loans made by Baltimore lenders to African-Americans.
- The top subprime lenders made at least 13 percent of all conventional purchase loans made by Baltimore lenders in low-income census tracts.

SUBPRIME LOANS IN PRINCE GEORGE'S COUNTY

Our findings show that subprime lenders make a disproportionate number of loans to lower-income and minority borrowers in Prince George's County. We identified the ten subprime lenders who originated the largest number of refinance loans in Prince George's County in 1998. These lenders originated 31 percent of all loans made by subprime lenders in the county in 1998 and over 36 percent of the refinance loans originated by subprime lenders. 1st Government Mortgage & Investors Corp.; FHB Funding Corp.; Option One Mortgage Corp.; AMRESCO Residential Mortgage Corp.; Advanta National Bank; Ameriquest Mortgage Co.; Pacific Shore Funding; Fidelity Mortgage Decisions; Mortgage Lenders Network USA; Champion Mortgage Co.

REFINANCE LOANS

The ten subprime lenders in this study originated 687 refinance loans in Prince George's County in 1998. These top subprime lenders originated refinance loans disproportionately to African-American and low income borrowers.

- African-Americans received a 1.4 times greater percentage of loans made by the top subprime lenders than they did of loans made by prime lenders.
- Low-income borrowers received a 3 times greater percentage of loans made by the top subprime lenders than they did of loans made by prime lenders.
- Moderate-income borrowers received a 2.9 times greater percentage of loans made by the top subprime lenders than they did of loans made by prime lenders.

	Prime Lenders	Subprime Leading Lenders
Percentage of Refinance Loans to:		
African-Americans	57.9	78.0
Low-Income Borrowers	8.9	26.8
Moderate-Income Borrowers	11.9	34.8

While the 687 loans made by these ten subprime lenders represent only 4.1 percent of all refinance loans made in Prince George's County, they constituted a much larger portion of the refinance lending to low-income and moderate-income borrowers.

- The top subprime lenders made 9.5 percent of the refinance loans made by Prince George's County lenders to low-income borrowers.
- The top subprime lenders made 7.6 percent of the refinance loans made by the county's lenders to moderate income borrowers.

Senator MIKULSKI. Would you have a seat, please, and identify yourself?

STATEMENT OF MATILDA WONSON, MEMBER, ACORN

Ms. WONSON. My name is Matilda Wonson. I am a member of ACORN. And I went to purchase my home back in September of 1998. I saw a number in a window and I called it, at 127 North Belfield Street, in Baltimore, Maryland. I called and I met up with an agent from Century 21, a real estate agent. And he helped me with the purchase of my home. And I went to buy my home. He helped me look at some houses. And I wondered, how come I cannot have that house over there? Certain houses I wanted he told me were not in my price range.

The house he was going to sell me was for \$44,000. And so I looked at those houses and I thought I picked the best one because it appeared everything looked good. And as we went along a couple of times, I was reading the paperwork that he gave to me, and the paperwork said something about house inspections. So I said to him about the house inspection, I said, oh, look, I have got to save up more money because he was telling me to save up money to give to him, and I said, oh, look, I have to save up another money order for an inspection.

And he said, oh, no, save your money. He said, you have all those kids, you need to save your money. And I said, but do not I need an inspection? And he said, do you think that the lenders would lend you that amount of money to purchase a home if it was not worth it. And me reasoning in my mind, would the bank lend me this kind of money, 54—because they end up upping the price of my house to 54? The house, I found out, was originally only \$14,000. And I reason in my mind, thinking, why would the bank give me this kind of loan for a house if it was not worth it? Because he told me that they do an inspection, too.

So I blame the lenders and I also blame the appraisers. Because how can you drop by a house and just say, oh, that is worth it? And even if you suspend their license, they still can practice it. And I do not think that is fair either. Because they are hurting a lot of people. They are not building the communities up; they are tearing it down. They are ripping people of their self-respect and their dignity.

My kids got caught up in this because I had a neighbor, her child used to come play with my children. I am the mother of seven kids, and she saw my house was in need of a lot of repairs. We had a big argument one day. She has a friend named Kelly Steinhorn that got involved in it, and they are friends. So me and her had this big thing. She wrote up a report that she came to my house because an argument was there, which was not true.

And so that is how DSS comes into the picture, and also wrote up that the plumbing is backed up and the house does not have a furnace. Because she was looking around in my house. And that she saw the ceiling how it was leaking and falling apart. She was like, this house is a mess. The kids cannot stay here. I was like, well, Miss, please do not do this, I said, because I am a good mother. I just made a choice to buy a house that was not the right house. I made a wrong choice.

And I feel like the real estate agent, they are supposed to help you in purchasing a home. I feel like he took advantage because he had more knowledge than what I had. And so that left me with all these bills and stuff that I am backed up in my bills, where I try to get some things done myself, but my furnace was not working, my kitchen sink was backed up, the ceiling was leaking. Every time you use the tub, the water comes down through the ceiling. Or you flush the toilet, the water would come down through the ceiling.

My front door is splitting down the front. I cannot even close it because it is splitting it so bad. And I called George, who is the owner of Century 21, 4 months. He says 6 months, but I say 4 months, after I went to settlement, on December 21st. I said, this

door is splitting down the middle. He said, well, we will help you until you can get the money to fix it. So they shot like four screws down the door and that was it.

The back door, I took it off at the basement. I went to open it because I was going to throw away an old mattress, the whole door comes off the hinge. Which I could not put it back on there because it was not a door that goes to the basement door, it was a door that would go to a bedroom door. The door had warped. And he never came back to do anything about that. The only thing I could do was put plywood up there. And the plywood was not good enough, because rats—I did not know they could squeeze through the cracks. So we have rats coming in our home.

So I explained all these problems to him. The only thing they did was shot the screws down the door. They never came back about the ceiling. He told me to call my insurance, the insurance that I took out on the home. He told me I could call them. But the real estate agent, he picked out my lender. He picked out my insurance. He picked out everything. He assured me, do not worry about anything. He befriended me. And I thought he was my friend. But he really took advantage because he had more knowledge.

And all of this stuff that is happening is coming from where people do not respect one another, they do not love one another, they do not care about one another. Because if you have love, "love" is an action word, you will not do anything to anybody. Now I have to go to court. I went Friday for my kids. And they postponed it until I could see if I could get more stuff done to the house. I asked for a postponement because my kids are with their maternal uncle until we can get something done on the house.

But it just does a lot. They are saying this is to help people, because we went to a meeting at Sky Court, and they are saying they are helping the community, when they are really taking from the community. They are not giving us anything. And what we do have, they are taking it.

I was a mother who was on welfare. I came a long way. I got on my feet. I went through the programs they set up. I got me a job. I did everything that I had to do. And then I said, well, I made it here, I am going to purchase me a home. That was my American dream that they took away from me. We cannot even stay there. They took it away and they made it like, oh, okay, I am going to sell you this house, whatever, whatever. Even when we went before the lender, I said, why are you raising the price of the house? He told me it was because, Matilda, you are going to want new carpeting and then you are going to want a washer and dryer in there.

I never got the new carpet. The washer and dryer, there was one in there that was in there from before, an old one. And the carpet that was on the floor when I went in there, it had so much fleas in it I had no other choice but to take it out.

Senator MIKULSKI. So it has been one thing after another.

Ms. WONSON. It is like a lot of repairs I have had to do on my home. And then I asked them to face me at the meeting, because they were trying to tell ACORN that I tore the house up. How can I tear down a furnace that was supposed to be new? How can I split my front door down the middle? All this stuff was supposed to be done when you purchase a home. There is no one to protect

us. Because we are the less fortunate or because we have less, it does not mean we should live less.

Senator MIKULSKI. That is right. Well, Ms. Wonson, we are here to try to protect you. And also this is a very gripping story. I am going to suggest that after our hearing, perhaps ACORN and Ken and Vinnie, we could talk with Ms. Wonson, because she is obviously in a situation not of her making, facing a protective service situation where she is not the problem. And let us see if we cannot help her with this immediate situation. We will come back and ask some more questions, but we thank you for your testimony.

Now, Mr. Quayle, do you want to come up. And you all do not have to leave. Let us give Mr. Quayle a chair next to Ms. Adams. And you stay right there. And, Ms. Washington, you stay right there. That way we can all have a good Q&A when this is over.

STATEMENT OF VINNIE QUAYLE, DIRECTOR, ST. AMBROSE HOUSING AID CENTER

Mr. QUAYLE. My name is Vincent Quayle. I direct the St. Ambrose Housing Aid Center here in Baltimore. I have been there for 32 years now.

I would like to preface this, Senator Sarbanes, by saying I am a great fan of FHA. Northwood was saved because of FHA. FHA did wonderful things and has throughout its history. It saved working-class and middle-class neighborhoods throughout this country, so I am a great fan of FHA. And I would not want to hurt FHA. I know we talked about that, and there is a concern there.

St. Ambrose got into this through our default mortgage department. Each year, we see about 1,000 families who are facing foreclosure. We have been doing this for 25 years. And 4 years ago, Frank Fisher, who run the department, came to me and said, Vinnie, there is something different going on out there in the communities. People used to lose their homes because they lost their jobs, they were sick or their marriage broke up. He said, today, we are getting families who are losing their homes because they could never afford the house in the first place. They were in over their head from day one.

So we began to look deeper into the issue. And I just want to make a few points. Baltimore has the highest per capita FHA foreclosure rate in the country. In numbers, we are three. Los Angeles has the highest numbers of FHA foreclosures. And Chicago last year had 1,200. We had 1,100. So we had 100 fewer foreclosures last year than the City of Chicago, with its size.

The problem arose because of two changes in FHA policy. One was, back in the mid- and late eighties, when FHA began allowing the lenders to underwrite and endorse their own loans. And I sold under the old FHA. I started out as a real estate agent. And the industry hated FHA. The lenders hated FHA because it took 60 to 90 days to get a loan approved. The real estate brokers hated FHA because FHA would send strict appraisers out, who would often reduce the sale of a house. And the sellers hated FHA because FHA made the sellers fix up the houses before they sold them. They made them put in new systems.

The current problem then arose when the lenders—now, more serious than that, in the late eighties, when the lenders took over the

endorsement, FHA still maintained some control, because they assigned appraisers from a list of approved appraisers. That changed 4 years ago. FHA allowed the lenders to choose their own appraisers. And this is when—it is really the last 4 years that have been a terrible problem here in Baltimore with FHA.

So what happened, two things happened. FHA abdicated its oversight responsibility. That is my first point. The second is, and it has been a problem ever since the beginning, FHA sells its houses as is. The VA does not. The VA fixes them up. FHA sells them as is. And that is what leads to destruction of these neighborhoods.

Senator Mikulski, you know this very well. This is the Shrine of the Little Flower right here on Belair Road. This is a tiny, little neighborhood behind it, a tiny, little neighborhood. It is four blocks by five blocks. But they are tiny streets. They are short. During the last 4 years that I have been talking about, FHA insured 193 houses in that neighborhood. There are 926 houses in the neighborhood. FHA insured 193. During this same period, 69 FHA homes went into foreclosure—69 out of 193.

Of course, this is the frightening figure across the city. In 1991, there were 1,900 petitions to foreclose in the whole of Baltimore. The petition to foreclose, that is the first step in the foreclosure process. The family is behind 5 or 6 months, the attorney for the lender files the petition. Last year, there were over 5,000 petitions to foreclosure in our city. There were only 10,000 real estate sales in Baltimore last year.

Senator MIKULSKI. That is citywide?

Mr. QUAYLE. Citywide. So for every two real estate sales, a house is going into foreclosure. Is that not extraordinary?

And this year, the first 2 months, we are up to 6,000 a year now. If this continues, we are going to have 6,000 this year. Something is going on. This is crazy. This is crazy.

So, if you asked me what to do, I have three recommendations. One is we have got to get some oversight back at the origination level of the loan. We do not have to go back to the old system. With technology, there has got to be a way where we can exercise some accountability up front, before the loan is made.

The second recommendation is that FHA, given the fact that we have the highest number, that FHA repair each of its foreclosed houses before it is resold. Senator Mikulski, I went out last Wednesday. I looked at 10 houses in the Shrine of the Little Flower there in that little neighborhood. There were all in lousy shape, lousy shape. I do not know how they were even approved when FHA first approved them.

But just to give you an example, those pictures I gave you, you know our row houses, how between the living room and the dining room you have these lovely columns and pillars in many of them. There were four houses with columns and they have all been removed. Now, one wonders what is going on. Who is going to buy a house where the decorative features have been removed? So those homes are going to go to investors and they are going to become part of the flipping process.

The third recommendation is I really think we should have moratorium on FHA foreclosures of occupied houses. And let us go and

see if fraud was involved in that case. And if it was, FHA should deny insurance to the lender. It would save tons of money.

Right now, back in the fall, in Maryland, FHA was sitting on 4,200 houses, which represented a loss of \$105 million. They lose \$25,000 per house. That is what FHA loses. The two most recent scams, Ms. Simon mentioned one of them.

Senator MIKULSKI. They lose \$25,000 per house?

Mr. QUAYLE. Per house.

Senator MIKULSKI. Can you estimate how many of these houses are in the HUD inventory in Baltimore?

Mr. QUAYLE. Well, you know HUD is having trouble. They had to fire their manager of the houses. Three months ago, Senator Sarbanes, when you had your hearing, there were 4,200. And Shirley Bryant, in the HUD office in Philadelphia, tells me that, since March, she has been getting 500 houses more a month, since March of 1999, which is a year ago. So she has gotten another 6,000 houses in the past year.

Senator MIKULSKI. Mr. Quayle, 6,000 times 25,000 is? I will not ask the banking committee.

PREPARED STATEMENT

Mr. QUAYLE. I am going to close by saying, in our default mortgage counseling program, we catch things early. We catch things early. Ms. Simon mentioned she is on an adjustable rate mortgage that was going to go from 10 to 17. This is the latest scam, using FHA loans. They are taking all these single moms who work at Johns Hopkins Hospital and earn \$18,000 to \$22,000 a year or they work in nursing homes. They are putting them on adjustable rate mortgages. And we know these folks' incomes are not going to go up, but the mortgage rates, we know what is happening to them. We are going to have tens of thousands more foreclosures because of it.

Thank you.

[The statement follows:]

PREPARED STATEMENT OF VINCENT QUAYLE

BACKGROUND

My name is Vincent Quayle and for the past 32 years I have directed the St. Ambrose Housing Aid Center in Baltimore which operates housing support programs to help predominantly minority families secure and maintain homeownership in Baltimore City.

Throughout these years we have worked with over 60,000 families who were trying to become homeowners or trying to save their homes from foreclosure. Most of those who did purchase homes and most facing foreclosure did so using the FHA insurance programs.

I consider myself a great friend and supporter of HUD and of HUD's FHA programs. From its inception St. Ambrose has received financial support from HUD for virtually all the housing programs we offer. I began my career in housing as a real estate agent in 1968 specializing in the FHA 221-d-2 program which literally saved homeownership in Northwood, Waverly, Edmondson Village, and dozens of other middle class and working class neighborhoods in Baltimore and other communities like Baltimore throughout the nation.

Until the mid-1980s FHA was a staunch defender of the buyer in the real estate transaction, as well as a staunch defender of itself. Real estate agents, lenders and sellers hated FHA. They hated the time it took to bring loans to settlement; they hated the strict appraisals which often reduced the contract price; and they hated the repairs that FHA demanded to the major structural systems of the house so the buyer would not soon be burdened with major repairs.

From the buyers and the neighborhoods' point of view FHA was a Godsend.

THE PROBLEM: FHA ABDICATES ITS OVERSIGHT RESPONSIBILITY

Baltimore has the highest number of foreclosures per capita in the nation. In 1993, Senator Mikulski, at our urging, you expressed your concerns to HUD about the growing FHA foreclosure problem in Baltimore. (cf. enclosed letter.) Now we are confronted with an epidemic.

In the mid-1980s one of two major changes occurred which altered FHA's relationship to the buyer and the neighborhoods. Faced with massive staff layoffs FHA began allowing lenders to endorse or underwrite their FHA loans. Prior to this FHA reviewed each loan to assure that all the rules had been followed. At first FHA was vigilant in looking over the lenders' shoulders but gradually removed even this oversight. Of course, FHA maintained some control over the loans by assigning appraisers from its own list of approved and experienced appraisers.

In 1994 the second major change occurred which we believe removed FHA's oversight of its own program at the loan origination stage. FHA now allowed the lenders to choose their own appraisers.

At this point the bad guys descended in droves. The number of FHA lenders in Baltimore City grew from 58 in 1994 to 107 in 1998 and the number of FHA loans grew from 2,153 to 3,821. During this same period the subprime lenders entered the Baltimore market and "flipping" became rampant. In 1999 over 2,000 of Baltimore's 10,000 real estate sales were "flips". While there is nothing inherently wrong with a "flip", the opportunity for flipping on a large scale would not be possible in Baltimore, if FHA treated its growing inventory of foreclosed houses properly. "Flips" often begin with FHA foreclosures.

I would like to make two points. My first point is that since 1994 FHA has been insuring thousands of bad loans in Maryland and particularly in Baltimore. FHA's abdication of responsibility at the origination stage of the loans has resulted in tremendous damage to the wonderful neighborhoods that are the hallmark and pride of this City.

Prior to 1994 families coming to St. Ambrose facing foreclosure came for three reasons: a loss of a job, illness or a marriage breakup. Times have changed. Since the door was opened to Direct Endorsers, folks come to us with mortgage problems that began with the very origination of the loan. FHA regulations have been circumvented and ignored. Briefly these regulations require that Buyers live in the house, have a good history of employment, an acceptable credit history, a modicum of savings and an income that is sufficient to carry out the monthly payment. We constantly see in our office flagrant examples of total disregard for each of these regulations. Cosigners are placed on the loan in order to qualify the Buyer for the payment and get the loan approved. Yet the cosigners have no intention of living in the house nor contributing to the household. When FHA regulations are flaunted, foreclosures result and neighborhoods deteriorate.

Below are FHA foreclosure statistics from 1996 through 1999 for a small 4 by 5 block area surrounding the Shrine of the Little Flower Church in Northeast Baltimore, a typical beautifully manicured working class neighborhood of 926 row homes that had never seen a boarded up house until these recent FHA loans fell into foreclosure.

Years	Number of FHA loans	Number of FHA loans in fore- closure
1996 thru 1999	193	69 (36%)

In four years and three months 28 percent of these loans have already filed for foreclosure. This is incredible!

As we look at what we are calling "bad loans" we see:

- loans that violated longstanding FHA rules and guidelines;
- loans with blatantly false appraisals that inflate the values of the houses;
- loans with excessive Loan value ratios;
- loans where the borrowers are putting up no money,
- loans with false gift letters;
- loans with false income statements;
- loans where sellers, through questionable nonprofits, are putting 12 percent cash into the deals and asking outrageous prices;

The old FHA protected the buyer, the neighborhoods and itself. The New FHA has abdicated its responsibility in overseeing the origination of its loans at great cost to the buyers, the neighborhoods and the taxpayer.

My second point is that FHA is destroying perfectly sound neighborhoods through its policy of selling its failures "as is". FHA's refusal to repair its failures to make them attractive to new homeowners is the single overriding reason why neighborhood like Little Flower begin the downward spiral. The VA and private lenders with conventional loans fix up their failures and resell the houses to homeowners.

Before 1994 the normal FHA portfolio of foreclosed houses in Maryland contained about 1,800 houses at any given time. By late 1999 FHA's Maryland portfolio had grown to 4,200 houses. Since March 1999, 500 houses per month have been added to this portfolio. Since FHA had to fire Intown Management, the company handling FHA's portfolio in Maryland, in 1999, this portfolio is probably approaching or exceeding 6,000 houses. One can imagine the effect of these eyesores on the surrounding communities.

In early 1999 FHA admitted to losing \$25,000 on each foreclosure. (We believe today's losses greatly exceed this amount per house.) At Senator Sarbanes' previous hearing on January 18, 2000 with 4,200 houses in its portfolio FHA faced a loss on its Maryland portfolio of \$105,000,000.

In a press release March 8, 2000, FHA congratulated itself on returning from its insurance fund to the federal treasury in 1999 \$1.5 billion (\$1,500,000,000). In other words, because of its policy of not fixing up its failures, many neighborhoods in Baltimore and elsewhere are collapsing because of FHA's "policy" of selling its failures "as is", while FHA turns back to the Treasury \$1.5 billion a year in profits.

FHA, which used to protect buyers and neighborhoods, is now at the beck and call of the mortgage bankers. The same "subprime" lenders responsible for the flipping phenomenon in Baltimore have moved into the FHA market because they know there is no oversight over FHA loans and lenders.

RECOMMENDATIONS

Since Baltimore has the highest number of foreclosures per capita in the nation we recommend that FHA institute a demonstration project in Baltimore with three objectives:

1. to review every FHA loan application prior to settlement;
2. to repair each foreclosed house and resell it to a homeowner; and
- 3 to declare a moratorium on occupied FHA foreclosures to see if fraud was involved in originating these loans. Where fraud is found, FHA should deny the lender's claim on its insurance fund.

To pay for the demonstration project FHA can draw upon a small portion of the \$1.5 billion (\$1,500,000,000) it returned to the U.S. Treasury in 1999.

St. Ambrose will be happy to assist FHA in this effort.

Senator MIKULSKI. Thank you very much for your testimony. We did the math on what you just said, the 6,000 houses.

Mr. QUAYLE. That is plus 48. So we are talking about 10,800.

Senator MIKULSKI. Let us just take 6,000 for a minute, times \$25,000. It comes out to \$150 million. That is \$150 million the Federal Government has lost. And when we think about the number of zip codes in Baltimore, if we could say what would be a Federal investment of \$150 million, this is far more than even almost its own community development block grant. So we are going to come back to your question. And we thank you for that.

We also want to note that, in addition to this excellent testimony, Ed Rutkowski sends a letter to you, Ken. Mr. Rutkowski, this is a letter from the Patterson Park Community Development Corporation, outlining what you see in Patterson Park. May I submit this for the record, please.

Mr. RUTKOWSKI: Sure.

[The information follows:]

PATTERSON PARK COMMUNITY DEVELOPMENT CORPORATION,
FEBRUARY 6, 2000.

KEN STRONG: Ken, here are my comments on FHA insurance. The central point of my argument is that there are essentially two FHA programs: one is successful

and is used in successful neighborhoods, e.g. new suburban developments or gentrifying urban neighborhoods like Canton; the second is used in declining urban neighborhoods like Patterson Park and Belair-Edison. Further, FHA administrators use national statistics to claim success for the FHA program overall. By doing that, they mask the dramatic negative effects of the "second" FHA program.

Before discussing the effects, let me discuss some of the characteristics of these neighborhoods:

- They have weakening, and in some cases collapsing real estate markets.
- As a result, property values are actually declining.
- Reliable appraisals are hard to come by for two reasons: there are wide variations in property values within short distances; and in old neighborhoods like those in Baltimore City, there are dramatic differences in house condition.
- The people who live in these neighborhoods are among the poorest and least educated in the metropolitan area.

Among the negative effects created by these conditions and FHA insurance are:

- As we have seen in Baltimore, because FHA is not locally administered, it is relatively easy for scam artists to take advantage of the poor and uneducated. FHA insurance becomes the vehicle of choice for selling real estate agents because buyers do not qualify for conventional loans. The problem was compounded when FHA allowed lenders to choose an in-house appraiser.
- In failing neighborhoods, rather than helping the poor create equity through homeownership, rather the program traps the poor in failing neighborhoods. Equity actually declines as property values declines. Settlement expense loans even start the buyer off with negative equity from the moment of purchase.
- The choices for a homeowner in a failing neighborhood are difficult. If they decide they have to move, their choices are:
- Default on their mortgage, ruining their credit.
- Rent the house, eventually renting to a difficult, often drug-addicted tenant; the frequent result is a damaged house which they cannot afford to repair, and so they default anyway. By then, the problem tenant has had a tremendous negative effect on the neighborhood.
- Lenders, especially for loans originated by mortgage brokers, have no incentive to prevent foreclosures by working with the buyer, nor do they have any incentive to work out any kind of pre-foreclosure agreement with a buyer. In the "successful" FHA program, workouts are increasing, again masking the lack of work-outs in the "unsuccessful" program.
- As noted above, the resulting HUD houses are invariably in very bad condition, often having to be boarded. These are eyesores at best, and remain so for a very long time because of the lack of a real estate market.
- In these neighborhoods, there is little if any homeowner market. HUD houses usually sell to investors.
- When sold to non-profits, like the Patterson Park CDC, HUD bases its discount on the extent of necessary renovation—the greater the necessary renovation, the greater the discount. However, the amount of renovation needed is based on the minimum needed to make the house habitable. That is not enough to attract a homeowner. While the nonprofit waits for HUD to reduce the price to an economically viable level, the vacant house sits.

Let me know if you have any questions.

Regards,

ED.

Senator MIKULSKI. I am going to submit this for the record.

I will go to my questions, first, to Ms. Adams and Ms. Simon, and then I will turn to Senator Sarbanes.

Ms. Simon, when you were brought into this, what were you actually told? First of all, did you go see this house?

Ms. SIMON. Yes. But that was not the first house.

Senator MIKULSKI. Did you see the house you bought?

Ms. SIMON. Yes.

Senator MIKULSKI. Did you do a walk-through for the house you bought?

Ms. SIMON. Yes.

Senator MIKULSKI. So you noted that it had problems?

Ms. SIMON. Not with the roof or the plumbing. The house was kind of like well-prepared, the carpet, the painting.

Senator MIKULSKI. So the cosmetics looked good; it was like a lot of nice makeup but a lot of orthopedic problems?

Ms. SIMON. Right.

Senator MIKULSKI. And then, when you went to buy your house, presuming that it looked good and therefore you thought it was good, and then you were discouraged from getting a home inspection; is that right? Did you ask for a home inspection?

Ms. SIMON. He said he would take care of all of that.

Senator MIKULSKI. Did you ever see a home inspection sheet? For example, when I bought where I live, I had a home inspection sheet that told me what the issues were. When you go to sell a house and the buyers ask for it, the home inspection tells you what you need to do before you sell. That is the paperwork for home inspections. You never saw that?

Ms. SIMON. No, ma'am.

Senator MIKULSKI. Which it should have looked at the roof and the plumbing and so on. Now, did you see the settlement document? In other words, did you see a sheet that said this is what the house cost? I think, in your instance, it was \$84,000. How much did you buy your home for?

Ms. SIMON. It was priced at \$65,000.

Senator MIKULSKI. Did you see the price and the fact that you had this balloon mortgage situation?

Ms. SIMON. I did not see the paperwork until I signed everything and got home and kind of looked over it. I went to Genesis Mortgage, the title company, and signed those papers. And then that is when I saw all of the information afterwards.

Senator MIKULSKI. Now, Ms. Simon, by asking you, I am really asking the three, so bear with me while I take you through this step. When you actually signed your papers, sitting at Genesis, usually, when you are at settlement, you go through and it is a tremendous amount of paperwork, but you go through each sheet and it is explained. Did anyone go through each sheet and explain this to you?

Ms. SIMON. Yes, they did.

Senator MIKULSKI. But you did not realize what you were signing with the balloon payment?

Ms. SIMON. No, ma'am.

Senator MIKULSKI. So was the balloon payment explained to you at settlement?

Ms. SIMON. He did not explain it this way. He did not explain it.

Senator MIKULSKI. So when you walked out, you thought that, in 15 years, by paying this \$600 a month, that in 15 years you would own this home on Chesterfield Avenue, one of the really nice blocks in Baltimore? I love Chesterfield Avenue. It is right on the park, close to St. Francis of Assisi Church and schools. And it is just a great block. But you thought you were going to own that house in 15 years?

Ms. SIMON. Yes, ma'am.

Senator MIKULSKI. For 600 and some dollars a month. So you looked at the monthly payment and years to be paid off. You did not know there was this balloon at the end?

Ms. SIMON. I did not understand it.

Senator MIKULSKI. Now, Ms. Adams, we will be talking to you more in the neighborhood, so I will come back.

Ms. WONSON. When you went to buy your house, did you see the conditions of that house?

Ms. WONSON. It was covered up. I did not know the ceiling was going to leak until we went to take a bath or flush the toilet or something like that.

Senator MIKULSKI. Did you flush the toilet or do any of that when you did your walk-through?

Ms. WONSON. No, I did not flush the toilet.

Senator MIKULSKI. Well, most people do not. I am not trying to make you feel awkward. Most people do not. So when you walked through, like with Ms. Simon, it looked good?

Ms. WONSON. Yes, it looked nice.

Senator MIKULSKI. So the appearance was deceptive?

Ms. WONSON. The only thing I asked him is, are you going to paint this, because I do not like flat paint. But he never did.

Senator MIKULSKI. But that is another minor thing, whether you like flat or glossy.

Ms. WONSON. But I am talking about that was the only thing that I saw, that they had done a fresh paint job.

Senator MIKULSKI. What happened when you asked, or did you ask for a home inspection?

Ms. WONSON. Yes. They told me, or he said, well, do you think that they would lend you this kind of money if the house was not worth it? Because he told me they do an inspection, too, the same way I had to pay him \$65 to check my credit, I had to pay them \$300, the lenders, to check my credit again. And I said, well, why do I have to give them a \$300 money order to check my credit? And he said, because they do a thorough check, too. And so he told me they even do an inspection on my home also before they give the loan. He said, why would they give you this loan if the house was not worth it?

Senator MIKULSKI. So you thought the bank had done the inspection?

Ms. WONSON. Yes.

Senator MIKULSKI. Let us go forward to the settlement, then I will come to Mr. Quayle and Mr. Strong. When you were at the settlement, that is where you sit there and sign the papers and, in some ways, you are signing up for the American dream, but in this case you signed your future away. I mean that is really what happened. I remember when I did my very first mortgage, in a very friendly and honest environment, I was so nervous about taking on this big responsibility. I even misspelled my name, and I had been signing that name for 28 years when I signed it. So I know how it can be overwhelming and so on.

Ms. WONSON. I was excited, plus I felt secure and assured because I had my real estate agent with me.

Senator MIKULSKI. So you felt you had a protector and an advocate?

Ms. WONSON. Yes, my agent.

Senator MIKULSKI. When you were there at the settlement, did they take you through the cost of your house, the mortgage that

you were going to be paying? Did you truly know what you were getting into?

Ms. WONSON. When they said I was going to be paying a different amount, I asked my real estate agent. I said, I thought you told me I was going to be paying \$362 a month. And he said to me, well, they rolled your insurance and your taxes in. And so I said, okay.

Senator MIKULSKI. So nobody explained to you that you had to do taxes and insurance?

Ms. WONSON. No. And also, some of that paperwork I was going through, I would be reading it and ready to sign it, and he would be like, I will explain that to you later, just sign it, it is for your home. I will explain that to you later. They were kind of like rushing the process because they had another settlement right behind me. And my agent, Tom Padgett, and the lawyer that was with them, who was Rob McFarland, they got into a big disagreement, so much to the point that they removed their self from the table. It was over money. They did not want other people to hear.

And so the lawyer, he ended up sending me \$1,500 to get appliances. But then Century 21 made a mistake and sent me \$1,500. So I do not actually know what the agreement was.

Senator MIKULSKI. This sounds very complicated. I am going to go to the policy issues, and then I am going to turn to Senator Sarbanes and come back to a few policy questions myself. But in my policy questions, I will be asking both Mr. Strong and Mr. Quayle and ACORN about the issue about pre-ownership counseling, so everybody knows how we either mandate or it is a requirement and, at the same time, we do not want to shackle the private sector. So I would like for you to think about that. And we will really also try to get some tips and insights from our members of the House of Delegates.

Senator Sarbanes.

Senator SARBANES. Thank you very much.

I would like to get from Ken Strong and Vinnie Quayle and Norma Washington their profile of the lenders. Ms. Wonson made a very strong statement that she really was, in effect, very much influenced by the assertion given to her that they are not going to lend all of this money if this house is not okay, right? That is what he told you, and that sounded plausible to you, right?

Ms. WONSON. Yes, it sounded good to me.

Senator SARBANES. Now, who is putting out this money and lending this money at these inflated rates on the flipping and lending it at, in effect, what seems to be subpar housing, even if there is not a flipping problem involved? What is your profile of the lenders?

I ask this question because I met with the Fannie Mae people the other day, and I have also talked to Greenspan. We need to figure out some way to dry up the availability of credit to these lenders to lend for these purposes. Now, what is your profile of the lenders?

Mr. QUAYLE. The first thing I would say is there are a lot of lenders involved in this. And there are a lot on these foreclosures. They are coming from our Baltimore banks. We did not think we

would see them coming from the Baltimore banks, but our local lenders are involved in these foreclosures.

Senator MIKULSKI. So they are both national and local?

Mr. QUAYLE. Yes. And a lot of the real scams are not from our banks or savings and loans. They are not at all. We have never found a case of fraud involving one of our Baltimore banks or savings and loans. But we have found foreclosures. The predatory lenders who were involved in these flipping scams have now gone into the FHA market because of this appraiser. I think it is because of this appraiser. They can choose whatever appraiser they want.

But the most startling thing that I heard recently is the President of Advanced Federal Savings & Loan—I sat at a committee hearing with him, and we were talking about this stuff—he said to me, these things are so profitable that we have pressure on us to get involved in the subprime lending. That is the scary thing. I mean these are minority savings and loans, and for the president to say we are not going to do it, but it is very tempting, that is what I would say.

Senator SARBANES. Well, let us separate the categories, though, because there is a subprime lending market that, as far as I can determine, is legitimate and makes an opportunity to get credit and to make a home available to people who would not have it. There is a subcategory of that market that is predatory and is engaging in practices that ought not to take place. And they need to be brought to a close. And then, even worse, these are, in effect, what are criminal offenses through this fraud we are talking about.

But I am trying to get a handle on who the lenders are in each of these categories. Who are the lenders who are playing this game that Ms. Simon and Ms. Adams came up against with the heavy flipping? Do you know, Ken? You are doing the research over in that part of town.

Mr. STRONG. I do.

Ms. ADAMS. Conti Mortgage.

Mr. STRONG. Conti Mortgage, the same company I referred to, sending the letter out, looking for refinance opportunities. As Mr. Quayle said, there are a great many lenders who are involved in this. You mentioned, Senator Sarbanes, in your opening, that—

Senator MIKULSKI. We need to know the categories. He is talking about the categories. Are these local banks?

Ms. WASHINGTON. A lot of these mortgage companies are owned by the bigger banks, but there are a lot of little mortgage companies involved in this. IMC is in it. A couple of the real estate people are in it. It is a lot of little companies. Commercial Credit is in it. What is the other one? There are a bunch of them.

They are little, bitty contingents that are in this. And a lot of them are owned by the bigger banks, that is true. But it is these little companies that are getting in this because they are turning the loans over within 10 days. They do not even own the loan anymore. They have already sold it. There are so many people involved in this that it is ridiculous. It is really, really ridiculous.

Mr. STRONG. In addition to the national subprime lenders that is one category, there are brokers who are selling the loan packages to those lenders who have never seen the house, who are only going

by what is on the paper. Often that information is fraudulent and trumped up. One of the practices we learned about is called the yield/spread premium, where the broker gets an additional fee for placing a loan at a higher rate than the buyers are eligible to receive.

So that if Ms. Adams qualified for an 8 percent loan, but I am the broker in this instance and I get her to take a 12 percent loan, when I market that package I get a bonus from the subprime lender. That is an awful practice and just rewards people for gouging consumers.

Credit Watch definitely needs to be enforced. Some of the characters HUD has targeted in its Credit Watch program are the same people involved in this. One of them has a 17 percent default rate, their interest rates are so high. They are still making money when they lose 17 percent of their loans to default foreclosure. But that is unconscionable to displace that many families and to have that many bad loans approved and then backed by FHA.

Senator SARBANES. And of course none of this focuses on the people who are meeting their payments that are having it really shorted out of them. We are talking to people here who really come close to losing out altogether. But other people take on these burdens and then they go through an incredible financial squeeze in order to try to meet them. And of course these people are reaping the benefits.

In fact, I gather you are saying they reap such benefits that they can afford an extraordinarily high failure rate. Is that correct?

Mr. STRONG. That is correct.

Senator SARBANES. Thank you very much.

Senator MIKULSKI. First of all, thank you. I want to go kind of go through the chain. And I am just going to focus really on the advocacy groups here. And in the interest of time, if you would like to give it a little more thought and get back to us, we would appreciate it.

First of all, do you think that in loans under \$75,000, or whatever limit, that there should be some type of recommended or mandatory consumer home ownership counseling?

Mr. STRONG. Yes.

Senator MIKULSKI. And, Ken, what would be your thoughts on that?

Mr. STRONG. Well, through the Coalition to End Predatory Real Estate Practices, we have had a committee looking at this. And one thing we recognized is that the quality of home ownership counseling needs to be upgraded across the board, to just have a counseling certificate in a very short visit near the end, close to settlement, in order to qualify.

Senator MIKULSKI. So what is the recommendation?

Mr. STRONG. It is to have higher standards of home ownership counseling and to require it.

Senator MIKULSKI. You mean for the people doing it?

Mr. STRONG. Yes. We need professional standards in home ownership counseling. Some is very good and some is not. We need a high standard of it and a requirement of it. Whenever government money is involved in the transaction, there ought to be that counseling.

Senator MIKULSKI. How about ACORN?

Ms. WASHINGTON. ACORN has a housing campaign, and we have put over 600 people in houses at a market rate. But we have a very intense counseling program, and we hold their hand from the time they hit the door until settlement. We are right there. We go over everything with them. They are not allowed to sign something that we do not think it is safe for them to do. Because a lot of the people are paying for mortgages and it is more than half of their salary. And they are targeting low income, and it is jamming them. And so we hold their hand from day one.

Senator MIKULSKI. Do you think that ought to be mandatory?

Ms. WASHINGTON. Yes, ma'am, I sure do. It should be mandatory across the board. These people, if you ask any one of them—and you can talk to any of these people—in this pamphlet right here, they will all tell you that they did not get counseling, they got befriended and told, I am your friend, I am not going to let anything happen to you. They never took them through the steps they should have taken them through. Because that would have been their loss, absolutely, across the board.

Mr. QUAYLE. I have been saying for years that anyone who gets a loan in excess of 100 percent of the sale price I think should have counseling before they go out and purchase the home. I think they should go and have their counseling, and before they get emotionally attached to a house, get a certificate that says this family has gone through this process. Then they can go out with a Realtor.

Senator MIKULSKI. So rather than set a dollar amount, your recommendation is 100 percent?

Mr. QUAYLE. I would tie it into the loan product, and it would be for the loan, where the buyer—I think it is a privilege that we, as a country, are giving folks an opportunity to buy a house, who do not have a lot of money to put into the deal. So if they are getting a 100 percent loan or in excess of a 100 percent loan, which is most of our low-income buyers today, I think they should be going through a process. They are the vulnerable people. They are the vulnerable.

Senator MIKULSKI. Now, let me ask the next question, because we are trying to wrap it up here. Appraisers, do you think that all appraisers, that anything for FHA, there should be some type of mandatory appraiser certification or licensing?

Mr. QUAYLE. I think FHA should go back and have its list of approved appraisers and have FHA assign the appraiser to each deal. What has happened is, once the lenders could choose their own appraisers, that is when the bad guys descended on the market.

Senator MIKULSKI. And that is one of the most direct punches?

Mr. QUAYLE. Absolutely. Senator Sarbanes, when the debt appraisal law went into effect, Baltimore's FHA lenders increased from 58 to 107. And I will give you the list of those 107. And the bad guys just descended on the market here in Baltimore when that happened. The old thing worked with the appraisers. But the problem is the appraiser has to bring it in at the lender's price or else they do not get paid. Whereas in the old way, FHA assigned the appraiser, so the appraiser got paid.

Senator MIKULSKI. I think those are really excellent recommendations to getting the prevention. Because one of the things

we are looking at is not only stopping, but also preventing. Now, will you be on the tour?

Mr. QUAYLE. I will be on the tour.

Senator MIKULSKI. Because when we do the walking around up in the North Robinson Street area, one of the things I am going to ask you is what is HUD contributing to being a slum landlord, the way they hold the property, the way they dispose of the property, and so on? Because my VA, HUD subcommittee will be holding a hearing on Thursday with Mr. Cuomo, and while we are talking about the prevention and the gouging of ordinary people trying to pursue the American dream, we want to look at HUD, FHA and how they disposed of the properties and what are they contributing.

It is like asset zones, where, for example, the nonprofit, like Patterson Park or Northwest Baltimore Community Development, they could literally buy these houses, renovate them and put them back in the marketplace, like we saw last fall when we did a walking around in the St. Elizabeth's area.

Well, thank you very much. And we really appreciate that. We will be talking with you more when we are out on the street. And we want to thank you for your testimony.

We again want to thank Ms. Wonson, Ms. Simon, and Ms. Adams for coming forward. You really have made a national contribution by telling this story. You are going to enable us to help many, so we really want to thank you.

Now, I would like to hear from Senator Sarbanes, and I would like to hear from our law enforcement community. We are therefore going to ask Ms. Battaglia, our U.S. Attorney; Mr. Mosquera, the Special Agent-in-Charge of the Baltimore FBI; and Mr. Jim Rowan, the Inspector-in-Charge of the U.S. Postal Service.

Ms. Battaglia, we welcome you and we invite you to proceed to tell us, because what we have noted is that, number one, in our conversations and in the newspaper, that there have been several indictments, and that you have investigations underway. Now, we acknowledge, the committee acknowledges, that a great deal of your work now is in the Federal grand jury or is a result of the Federal grand jury and you are unable to share with us the information because of legal constraints. So if we ask questions and we are going in directions inappropriate, please tell us. But what we are really looking at is pattern and practice and what we can do in terms of stopping the criminal aspects.

STATEMENT OF LYNNE BATTAGLIA, U.S. ATTORNEY FOR MARYLAND

Ms. BATTAGLIA. Thank you, Senator Mikulski and Senator Sarbanes. We are pleased to be here as representatives of the law enforcement community in Baltimore and in the rest of the State.

As you know, this problem is not only in the State, it is across the Nation. And when we are talking about mortgage flipping, we are talking about a specific type of fraud, when an individual purchases a low-cost inner-city housing, and then quickly sells that house, that day or within about 60 days, which is what we have normally seen, at a substantial profit. While that is not, per se, illegal, and it is certainly a part of the American dream also that you

have a profit, it does signal that there is something going on that is less than aboveboard.

And what we found is that the resale in the fraudulent area is being accomplished through falsely inflated appraisals—you asked about those—sham second mortgages, sham deposits, phony gift letters and loan applications littered with false credit and financial information. As you noted, the United States Attorney's Office is deeply committed to prosecuting this type of fraud, along with our partners in the FBI, as well as in the Postal Inspection Service. And with the investigators from HUD, we do that through looking at these materials in the grand jury process, as Senator Mikulski noted. And as such, we cannot talk about some of the aspects.

But I would bring to your attention that while we have been talking about Baltimore City, where mortgage flipping is in full bloom, we should also be talking about it in Prince Georges County, where the issue is germinating and looks as though it is also going to bloom. When we are talking about mortgage flipping, we have been talking about the fact that individuals buy these homes from people who are flipping the houses. We should also be talking about the fact that investors also buy these properties.

When I am talking about investors, I am talking about people who buy these houses with the hope that they can make money from renting them. These are legitimate investors. And what they do is they go in and they buy the house at a lower rate and hope that they will be able to rent the house to pay the debt service.

Now, what happens is the individuals who buy the home, as you have heard, find out about the home through ads in the newspaper. And the individuals are lured into this by the representation that they only have to pay \$500 down. What actually happens is the seller has bought the house for approximately \$10,000 to \$15,000 and then makes cosmetic repairs in the amount of \$10,000. That would take it to \$25,000 approximately. And thereafter, through false appraisals, phony lending documents, gift letters and all of that, they induce the lender to lend at a higher rate.

They may offer the house, as you have heard, at \$45,000, \$55,000, \$85,000. And one of the questions that you asked was, do we have local lenders? What we have found in the fraud arena is that the mortgage brokers get out-of-state lenders to lend on the amount that the house is offered at. And the out-of-state lenders rely on the appraisal. They do not come to Baltimore to actually look at the houses. So they relied on the false appraisals and the false documents, such as a phony second mortgage and lend approximately 70 percent of the value.

So that, in the end, the lenders, who are out of State and who are also the victims in this, have lent at 120 percent of the value of the house. What happens is if the buyer of the house, whether it is an investor or an individual, can meet the payments, the company out of State is not out any money and no one else is victimized except the individual who has bought the house. And as Senator Sarbanes noted, they are paying a debt service that is higher than they should be.

What happens, though, most of the people who buy these houses, whether they are the investors or the individual purchasers, they oftentimes find that with the increased amount of money that they

have to pay for insurance as well as taxes, because oftentimes these amounts are based upon the purchase price of the house, they cannot pay for these houses.

You have heard about the fact that many of the houses are in disrepair. But, ultimately, there is a default because they cannot pay the amount of money that they have to pay every month for these houses. The loans go into default. The mortgage company forecloses. And all of this is done because of the reliance on forged contracts, fraudulent appraisals, phony rent receipts, phony leases, fraudulent down payments that are supplied by the seller but appear to be paid by the buyer, false gift letters and false letters from settlement agents, stating that they are holding a down payment when in fact they are not.

The scheme is the same whether we are talking about investors or individual people. And, ultimately, what happens, not only in Baltimore but thousands of times across the country—and we are talking about Newark, New Jersey; Milwaukee, Wisconsin; in cities all across the country—it is the same type of scheme. We are talking about a nationwide problem that my colleagues not only in the FBI and the Postal Inspection Service are seeing, but at the U.S. Attorney's Office.

So we are asking, obviously, for your help because of the fact that the more these loans go bad, the more of an effect that we have in the same type of way that we had in the savings and loan industry in the eighties. It is the same type of scheme that we see. And we see the same type of impact that can be had not only in terms of the banking industry but in terms of the people who were victimized. What we saw in the savings and loan industry was we saw vulnerable retired people and people who could ill afford to have that happen there, we are seeing the same type of thing here.

Again, the bottom line is that the sales, whether to residents, purchasers, or to investors, appear to have caused fairly stable rental neighborhoods to become destabilized through the process of what amounts to temporary home ownership. The destabilization manifests itself in the form of boarded up and vacant housing, which, as you know, leads to a crime epidemic in terms of drug dealing. And to make matters worse, it carries with it the possibility of nationwide economic disruption.

PREPARED STATEMENT

We need to take into consideration the fact that we not only have stark human dilemmas that you have heard about, but the potentially drastic national economic consequences. And that is why we are here today to talk to you about it, and hopefully we will be able to resolve this issue not only in Baltimore and Prince Georges County, but throughout the Nation.

Thank you.

[The statement follows:]

PREPARED STATEMENT OF LYNNE A. BATTAGLIA

Mr. Chairman and Senator Mikulski: Property flipping is the term used to describe the situation in which an individual or entity purchases a low cost inner city housing unit and then quickly—sometimes the same day though almost always within sixty days—re-sells that property at a substantial mark up. While there is nothing per se unlawful about an immediate turn around at a substantial profit, it

is oftentimes a sound indicator that the re-sale is being accomplished through falsely inflated appraisals, sham second mortgages, sham deposits, phony gift letters, and loan applications littered with false credit and financial information.

The United States Attorney's Office in the District of Maryland is committed to prosecuting the perpetrators of these crimes and currently has about 15 open cases. Most of them relate to property transactions in Baltimore City, though some occurred in Prince George's County, where we see the problem germinating. Of course, here in the city, the problem has fully bloomed.

Much of our information has come through the grand jury process, and as you may know, I am not permitted to disclose publicly grand jury material. Accordingly, my comments today must, of necessity, be rather general. With that in mind, let me move on.

The individuals who are purchasing houses are either individuals who intend to live in the home or, what we refer to as "investors." The investors appear to be primarily working people with some savings who are enticed into buying blocks of houses—three to ten at a time—with the understanding that they can receive cash back at settlement and that the rental income will cover the debt service, all as the value of the house increases over time. What the investors discover is that the houses are money pits. Over time, the houses suck more and more cash from the investor until he simply declares bankruptcy or otherwise walks away from the properties.

In some cases, an individual is purchasing one house in which to live. These people often respond to ads in the newspaper in which it is claimed that for some nominal sum paid as a deposit—like \$500—the person can then purchase a home where the monthly payment is essentially the same as what the person is now paying as rent. If this sounds, as the expression goes, too good to be true, it is. In these situations, the purchaser typically signs a contract for about \$45,000. This is a home that the seller has recently bought for between \$10,000 and \$15,000 and made about \$10,000 worth of cosmetic repairs. Unfortunately, many of the lenders will only lend about 70 percent of the value of the property. In the typical case, 70 percent of the contract price will not generate enough of a profit for the seller. Therefore, the seller creates a phony second contract, supported by a fraudulent appraisal, falsely stating that the sales price is about \$75,000. By so doing, the mortgage company is tricked into lending about \$50,000. That sum covers all of the original contract price plus all related expenses. Instead of lending 70 percent of the value of the property, the lender has lent about 120 percent of the value.

It is often the case that the resident homeowner finds that he or she cannot make the monthly mortgage payments (which, of course, has been determined on a loan amount that exceeds the actual value of the property). The property tax and insurance bills are higher than they should be because the sales price has been inflated. The homeowner finds that he or she cannot pay these inflated expenses, the fairly high monthly mortgage costs, and keep the property well maintained. This leads some of the homeowners to default on the mortgage, declare bankruptcy, or otherwise walk away from the property.

In both of these cases, the fraud is generally perpetrated through the use of forged contracts, fraudulent appraisals, phony rent receipts, phony leases, fraudulent down payments that are supplied by the seller but appear to be paid by the buyer, false gift letters, and false letters from settlement agents stating that they are holding a down payment, when in fact they are not.

Whether we are talking about investors who purchase blocks of houses, or whether we are talking about an individual who has purchased the home to live in it, there is an additional consequence which relates to what the mortgage company does with the loan after the loan has been made. Many of the mortgage companies sell the loans to large institutions as investments. These investments appear to be very safe because they are backed by real property, that is, the homes. However, when the borrower—whether it is an investor or a single homeowner—defaults on the mortgage, the investor discovers that the investment does not have the collateral to cover the loan. If it happened in one or two, or even a hundred or two hundred cases, the consequences would not be so bad. The real problem is that it is happening thousands of times in Baltimore and thousands of times in Newark, New Jersey, and thousands of times in Milwaukee, Wisconsin, and thousands of times in cities all over the country. This means that across the country there are tens of thousands of loans being made with inadequate collateral. The more of those loans that go bad, the more the large institutions that own these loans are hurt. In short, we have the makings of an economic crisis that is similar to the savings and loan crisis of the 1980's.

Again, the bottom line is that the sales—whether to resident purchasers or to investors—appear to have caused fairly stable rental neighborhoods to become de-sta-

bilized through the process of what amounts to temporary home ownership. The destabilization manifests itself in the form of boarded up and vacant houses. And, to make matters worse, it carries with it the possibility of nationwide economic disruption.

It is for all of these reasons—the stark human dilemmas as well as the potentially drastic national economic consequences—that the U.S. Attorney's office, the FBI, the Postal Inspectors, and the investigators from the Department of Housing and Urban Development have made property flipping and predatory real estate practices a priority.

I would be happy to answer any questions that members of the Subcommittee may have.

Senator MIKULSKI. Thank you.

Mr. Mosquera.

**STATEMENT OF RICHARD M. MOSQUERA, SPECIAL AGENT-IN-CHARGE,
BALTIMORE FIELD OFFICE, FEDERAL BUREAU OF INVESTIGATION,
DEPARTMENT OF JUSTICE**

Mr. MOSQUERA. Good morning. My name is Rick Mosquera. I am the Special Agent-in-Charge of the FBI here in Baltimore. Our territory covers the entire State of Maryland, as well as the State of Delaware. And I would like to thank you for the opportunity to appear here today.

I am here to speak about this crime problem affecting both the State of Maryland and the City of Baltimore, commonly known as property flipping. We have heard testimony here this morning by victims of this criminal practice. We have also heard how the scheme works, utilizing false appraisals and phony loan documents to get an unwitting homeowner into their first home.

But, in addition to the first-time victim homeowner, who else loses in this scheme? In the last 4 years, the Maryland Department of Assessments and Taxation has identified 2,000 houses in Baltimore City alone that were bought and then sold a short time later for at least double the first sales price. The Baltimore Sun reported last August that three lending institutions, two of them from out of State, have filed two separate lawsuits here.

One suit claims that the lender has financed \$820,000 in bad loans here in the City, most of which are either in default or delinquent. On 21 of these loans, the mortgages total \$777,000, yet the total reappraised value of these homes combined is only \$555,000, a difference of almost a quarter-of-a-million dollars.

In another lawsuit, two lenders have claimed that they were induced to finance almost 150 fraudulent mortgages here in the City, many of which were vacant and in disrepair at the time of purchase. In an interview conducted by one of our agents last week, a California lender called Baltimore a dysfunctional market that is very nearly leading the Nation in subprime foreclosures. This particular lender is currently facing 120 foreclosures in Baltimore, with losses exceeding half-a-million dollars.

Last December, the Sun reported that Baltimore has one of the worst default rates in the country on loans insured by the Federal Housing Administration. In testimony before the Maryland General Assembly 2 months ago, the Commissioner of Financial Regulation for the State of Maryland testified that Maryland ranks fifth in the Nation in mortgage fraud. Only New York, California, Florida, and Illinois have a larger problem in this area.

Beginning on July 1st of the upcoming fiscal year, the City will begin to lose nearly \$1 million annually in lost revenues on more than 3,700 properties that were overvalued through false appraisals. Who pays for all of this? In a word, everyone.

The individual buyers pay when they lose their first home. Senior citizens on fixed income pay when their property taxes go up due to inflated appraisals on properties in their neighborhood. Private lenders pay by underwriting bad loans. The Federal Government pays by insuring these bad loans. We, the taxpayers, pay when our taxes are spent in cleaning this mess up.

When out-of-state lenders file lawsuits in Baltimore's Federal and circuit courts, the lending industry notices. When our State ranks fifth in the Nation on mortgage fraud, banks may think twice about financing first-time home buyers in Maryland. When houses are foreclosed upon and go vacant, drug dealers notice. In no time at all they become bustling crack houses and shooting galleries. As a result of the pervasiveness of this problem, not just in Maryland but across the United States, this past fall Federal law enforcement joined ranks to coordinate investigative efforts in this area.

With \$18 million in Federal funding from the Congress, six task forces were formed across the country where the problems are most acute. One of those task forces is located here in Maryland. Over 25 investigators and auditors from the HUD Inspector General's Office, the FBI, the United States Postal Service Inspectors, and the IRS are involved. U.S. Attorney Lynne Battaglia has dedicated several of her prosecutors to this initiative.

In the FBI alone, we have over 20 active investigations targeting those who we have identified as the most prolific and egregious violators. These investigations are labor intensive and time consuming. When you consider that the average mortgage fraud nets 10 times what is taken in the average bank robbery, our efforts are more than justified.

PREPARED STATEMENT

I believe that due to the support now being provided through Congress, the synergistic approach by law enforcement and the aggressive prosecutor strategy by the United States Attorney's Office, we have great potential for significantly reducing this criminal practice.

Thank you.

[The statement follows:]

PREPARED STATEMENT OF RICHARD M. MOSQUERA

Good morning. My name is Rick Mosquera and I am the Special Agent in charge of the FBI office here in Baltimore. Our territory covers the State of Maryland, as well as Delaware. I would like to thank Senators Mikulski and Sarbanes for the opportunity to appear here today.

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In an interview conducted by one of our Agents last week, a California lender called Baltimore a "dysfunctional market" that is very nearly leading the nation in sub-prime foreclosures. This particular lender is currently facing 120 foreclosures in Baltimore with losses exceeding half a million dollars. This lender anticipates that due to all the attention this problem is receiving here, the Philadelphia market will be targeted next.

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These investigations are labor intensive and time consuming. When you consider that the average mortgage fraud nets ten times what is taken in the average bank robbery, our efforts are more than justified.

I believe that due to the support now being provided through Congress, the synergistic approach by law enforcement, and the aggressive prosecutive strategy by our U.S. Attorney's Office, we have great potential for significantly reducing this criminal practice. Most importantly we are all here committed to ensure that every citizen has the opportunity to pursue the American dream.

Senator MIKULSKI. Thank you. It is Bonnie and Clyde now wearing Feragamo shoes and Italian suits and so on. But it is a new form of bank robbery is what you are saying.

Mr. Rowan, of the Postal Service.

STATEMENT OF JAMES J. ROWAN, JR., INSPECTOR-IN-CHARGE, U.S. POSTAL INSPECTION SERVICE, WASHINGTON METRO DIVISION

Mr. ROWAN. Good morning, Senator Sarbanes, Senator Mikulski. My name is James J. Rowan, Postal Inspector-in-Charge of the

Washington Metro Division of the U.S. Postal Inspection Service. I appreciate this opportunity to appear before you today to discuss mortgage flipping investigations and the impact these schemes have upon citizens of Baltimore, various financial institutions and the real estate market in Maryland.

I want to thank you for the interest you have demonstrated by scheduling this hearing to address this problem. Your efforts provide one more means to educate the American public to prevent them from being victimized by this scheme.

I would also like to thank U.S. Attorney Lynne Battaglia for her prosecutorial leadership in this area. Perhaps our best known remedy is the criminal mail fraud statute, 18 U.S.C. 1341. During the past fiscal year, inspectors responded to approximately 70,000 consumer fraud complaints, conducted 3,427 fraud investigations, and arrested 1,523 individuals associated with fraudulent schemes. Because it is essential that the public have full confidence in the mail, postal inspectors are intent on preserving the integrity of the U.S. mail through vigorous law enforcement, public education and crime prevention efforts.

It is this statute that we have used in the mortgage arena. The Inspection Service is conducting 13 investigations into mortgage flipping and other real estate frauds in eight major cities in the United States. Earlier indications suggest there is an increase in the number of mortgage-related referrals to the Postal Inspection Service for investigative attention.

Postal inspectors in Baltimore began an investigation into so-called flipping schemes after an attorney who was representing Baltimore City home buyers complained to our field office and the United States Attorney's Office in 1998. The attorney represented clients who had purchased properties from Robert Beeman and Walter Duersch at inflated prices. Based on the information provided by the attorney and the fact that the mail was used to transmit documents and checks, we opened an investigation.

Documents obtained from public records, the individual victims and company records were reviewed. They were compared to determine time lines on when certain activities occurred. I will provide some insight into the Beeman-Duersch, however, due to grand jury proceedings, I am limited in what I can discuss.

After the initial review of documents, postal inspectors went to the Maryland Department of Assessment and Taxation, with the assistance of State Assessor Richard Sause, specific neighborhoods were identified where properties were being flipped. Through Mr. Sause's efforts, additional victims and suspects were identified.

Since the single complaint that initiated the Beeman-Duersch investigation, postal inspectors have discovered 12 to 15 additional flipping schemes operating in Baltimore. In addition, we have participated in investigations in Miami, Chicago, Newark, St. Louis, and other cities across the United States. We heard from Ms. Adams and Ms. Simon this morning. We have heard how they were victimized by Robert Beeman. In Baltimore, postal inspectors reviewed thousands of real estate transactions. Working with the attorney and community organizations, postal inspectors found and interviewed over 100 individuals since February 1998.

We have worked closely with Lynne Battaglia and prosecutors with the United States Attorney's Office. And I am happy to report, just 3 weeks ago, we presented details of the scheme that led to the indictments of Robert Beeman and four other individuals in Baltimore for mail and wire fraud. The details of this scheme present an image of greed, exploitation and disregard for low-income families and disadvantaged buyers of real estate properties in Baltimore.

Through deception and a collaborative effort to misrepresent the truth, approximately 200 Baltimore families have been identified as victims of this latest mortgage flipping bonanza. Our investigations have determined that approximately 20 to 30 mortgage flippers are operating in the City of Baltimore. In some cases, individuals engaged in this enterprise have flipped over 200 homes in a period of 2 years. With a potential profit of \$10,000 to \$20,000 per home, these operators can realize lucrative returns, in the neighborhood of \$4 million.

As active participants in the flipping task force created by Ms. Battaglia, we work closely with the Maryland State Attorney General's Office, as well as with other State and City government agencies. In 1999, an estimated \$3 billion was loaned for mortgages in the Baltimore area. Baltimore has an unflattering reputation of having one of the highest default rates for mortgages in the country. We estimate that at least 75 percent of the mortgages are sold in the secondary market. Often the mortgages are sold without recourse.

Simply stated, a company purchases a mortgage note from a lending company. And if that mortgage should go into default for any reason, they simply cannot recover their loss. Our inspectors have interviewed officials in these companies who have told us the vitality of their companies have been jeopardized due to the flipping epidemic. They have echoed a concern that mortgage companies may not want to touch any mortgage business in Baltimore due to the flipping problem.

Many buyers that postal inspectors have encountered in this investigation were forced to default on their loan and walk away from their house. It should be noted that for many of these victims, this was their first home. They hoped it would be their dream home. Unfortunately, for many, it turned out to be their worst nightmare.

The Postal Inspection Service will continue to provide investigative resources to this problem. However, additional preventive efforts are needed to keep home buyers from becoming victims and to keep Baltimore from continuing the downward spiral in the mortgage business.

PREPARED STATEMENT

Again, I would like to extend my appreciation to the committee, Senator Mikulski and Senator Sarbanes, for the opportunity to discuss this problem today.

[The statement follows:]

PREPARED STATEMENT OF JAMES J. ROWAN, JR.

Good morning Senator Mikulski and Senator Sarbanes. I am James J. Rowan, Postal Inspector in Charge, Washington Metro Division of the U.S. Postal Inspection Service. I appreciate this opportunity to appear before you today to discuss mortgage-flipping investigations and the impact these schemes have upon the citizens of Baltimore, various financial institutions, and the real estate market of Maryland. I want to thank you for the interest you have demonstrated by scheduling this hearing to address this problem. Your efforts here provide one more means to educate the American public to prevent them from being victimized from this scheme. I would also like to thank U.S. Attorney Lynne Battaglia for her prosecutorial leadership in this area.

The Postal Inspection Service is the primary law enforcement arm of the U.S. Postal Service, enforcing over 200 federal criminal and civil statutes. We are responsible for protecting postal employees, the U.S. Mail, and postal facilities from criminal attack, and for protecting consumers from being victimized by fraudulent schemes or other crimes involving the mail. We also work to rid the mail of drug trafficking and money laundering, mail bombs, and perhaps one of the most despicable crimes: child exploitation. The Postal Inspection Service, which employs about 2,100 Postal Inspectors, 1,400 Postal Police Officers and 900 professional, technical and support employees, has performed many of these duties for over 200 years and is one of the oldest federal law enforcement agencies.

A number of statutes enable us to take action against fraudulent practices involving the use of the mail. Our primary weapons are two statutes originally enacted over 125 years ago: the criminal mail fraud statute and civil false representation statute. The public policy that underlies these statutes remains valid today: The postal system created by Congress to serve the American public should not be used to conduct schemes that seek to cheat the public.

The nation's mail service was designed to assure that there was always a reliable, efficient, affordable, and secure means of communication for its citizens. Last year, a Harris Poll affirmed that the American public feels significantly more confident about the security of mail than they do in telephone or Internet communications. Even in a world of advanced technology and instant communications, the people and businesses of this land feel more secure with a hard copy delivery system that is backed by a U.S. Government guarantee: the Postal Inspection Service. Our mission is to prevent unscrupulous promoters from damaging that confidence.

INSPECTION SERVICE JURISDICTION

Perhaps our best-known remedy is the criminal mail fraud statute, 18 U.S.C. § 1341. During the past fiscal year, Inspectors responded to approximately 70,000 consumer fraud complaints, conducted 3,427 fraud investigations, and arrested 1,523 individuals associated with fraudulent schemes. Because it is essential that the public have full confidence in the mail, Postal Inspectors are intent on preserving the integrity of the U.S. Mail through vigorous law enforcement, public education, and crime prevention efforts.

When the proceeds of a crime are used to further illegal activity or are concealed, we have authority under the asset forfeiture and money laundering statutes to forfeit the proceeds or property acquired with them. Our first consideration in dispersing forfeited funds is to return them to the victims whenever possible. Mail Fraud investigations conducted by Postal Inspectors in fiscal year 1999 to protect postal customers resulted in voluntary restitution of about \$3.8 million, fines of over \$5.6 million and court-ordered restitution of over \$602.4 million.

MORTGAGE FLIPPING

The Inspection Service is conducting thirteen investigations into mortgage flipping and other real estate frauds in eight major U.S. cities. Early indications suggest an increase in the number of mortgage-related referrals to the Postal Inspection Service for investigative attention.

Postal Inspectors in Baltimore began an investigation into so-called "flipping" schemes after an attorney who was representing Baltimore City home buyers complained to our field office and the United States Attorney's Office in 1998. The attorney represented clients who had purchased properties from Robert Beeman and Walter Deursch at inflated prices. Based on the information provided by the attorney and the fact the mail was used to transmit documents and checks, we opened an investigation. Documents obtained from public records, individual victims and company records, were reviewed. They were compared to determine timelines on when certain activities occurred.

I will provide some insight into the Beeman-Deursch investigation. However, due to Grand Jury proceedings, I am limited in what I can discuss. After the initial review of documents, Postal Inspectors went to the Maryland Department of Assessment and Taxation. With the assistance of State Assessor Rick Sause, specific neighborhoods were identified where properties were being flipped. Through Mr. Sause's efforts, additional victims—and suspects—were identified. Since the single complaint that initiated the Beeman-Deursch investigation, Postal Inspectors have discovered 12 to 15 additional flipping schemes operating in Baltimore. In addition, we have participated in investigations in Miami, Chicago, Newark, St. Louis, and other cities across the United States.

In Baltimore, Postal Inspectors reviewed thousands of real estate transactions. Working with the attorney and community organizations, Postal Inspectors found and interviewed over 100 individuals since February of 1998. We have worked closely with Lynne Battaglia and prosecutors with the United States Attorney's Office, and just three weeks ago, presented details of the scheme that led to the indictments of Robert Beeman and four other individuals in Baltimore for mail and wire fraud.

The details of this scheme present an image of greed, exploitation and disregard for low-income families and disadvantaged buyers of real estate properties in Baltimore. Through deception and a collaborative effort to misrepresent the truth, approximately 200 Baltimore families have been identified as victims of this latest mortgage-flipping bonanza.

The wake of destruction caused by these schemes has left many families homeless, saddled with poor credit ratings, and in the case of those with no place else to go, the owners of homes with significant mortgage debt in need of major repair. If homeowners attempt to refinance these properties, they soon realize their home was appraised at an inflated value, and therefore not eligible for a lower interest rate or a home improvement loan.

While some efforts to rehabilitate and market homes are undertaken by legitimate investors, many examples of homes that are purchased and sold with no interest in redevelopment represent the true nature of this scheme.

Our investigations have determined that approximately 20–30 mortgage flippers are operating in the city of Baltimore. In some cases, individuals engaged in this enterprise have flipped over 200 homes in a period of two years. With a potential profit of ten to twenty thousand dollars per home, those operators can realize lucrative returns in the neighborhood of \$4 million.

As active participants in the flipping task force created by Ms. Battaglia, we work closely with the Maryland State Attorney General's Office, as well as with other state and city government agencies.

The mortgage-flipping scheme works like this:

- Flippers target homes that are being sold at auction by HUD or at bank foreclosure sales. In the Beeman case both auctions and foreclosure sales were used to obtain properties.
- Before settlement, the flippers are allowed—by HUD and some banks—access to the property. The flippers show the house to potential clients, sometimes promising to make cosmetic repairs to the house. The same day the flippers settle with HUD or the banks, they re-sell the home for as much as twice the amount they paid. This sets the groundwork for what is now commonly known as the “same day flip.”
- The flippers lure people in easily. They place advertisements in local newspapers, such as the *Baltimore Sun* and the *City Paper*, stating that the buyer could purchase a house for what they pay in rent. The flippers seek out first-time homebuyers, often women, or naive individuals looking for investment properties. Our investigation revealed ads were placed in local Baltimore papers in the Beeman investigation.
- In the Beeman investigation, as well as other cases under investigation, buyers are quoted prices between \$40,000 to \$50,000. They are asked to make a modest deposit between \$500 to \$1,000. The buyer is then asked for some personal financial information. The flipper advises the buyer that someone will be in touch.
- After a few days, a mortgage broker calls the buyer and tells him or her that they have been pre-approved for a mortgage. The mortgage broker requests a meeting with the buyer to discuss personal finances. In the Beeman case Postal Inspectors interviewed people who said a mortgage broker contacted them shortly after signing a contract with Beeman, advising they have been pre-approved for a mortgage.
- The mortgage broker shops around to the various mortgage-lending companies. Many of these companies are from out of state and are not familiar with the

Baltimore housing market. Some of the mortgage companies are federally insured financial institutions. This is one of the many phases where loan packages and checks are sent through the mail, providing jurisdiction for the Postal Inspection Service to be involved in the investigation.

- When a mortgage lending company is found, the broker and the company establish a loan-to-value ratio for the transaction. This is often termed the “LTV.” The LTV is basically the formula that the mortgage-lending company would agree to in order to make a loan. For example, the lending company will tell the broker they want an LTV of 75–15–5. That means they are willing to finance 75 percent of the mortgage only if the seller takes a second mortgage of 15 percent and the buyer places a 5 percent deposit on the property. The lenders, seeking to ensure the safety of their investments, want the flippers to have a stake in the house, too. To get around these problems, the flippers inflate the property value to at least 100 percent over the property’s market value so they can receive more money from the banks.
- The mortgage broker submits a contract to the lenders reflecting a higher price for the property than the buyer is told about. In the Beeman and Deursch schemes, the buyers claimed that their signatures were forged on the contracts sent to the lenders. In order to secure the loan, the flippers and the mortgage brokers present the lender with false documents in an effort to show that the buyer is more credit-worthy than is true. The documents include fake wage information, phony employment information, false gift letters, fictitious financial histories, or fake rent documents.
- The key to the scheme is the appraisal. For the scheme to be successful, an appraisal, which is supposed to be independent, must be completed that verifies the home is worth the inflated amount or the bank won’t lend the money. Appraisers work hand in hand with the flippers. They write appraisals stating that the property had been “totally renovated,” or indicate there are “new appliances” to justify higher prices than other similar properties in the neighborhood. Appraisers involved in the scheme would often use properties that had already been flipped as comparables. The flippers and the mortgage brokers often “cooked” the appraisals themselves by providing the appraiser with comparables of other already flipped houses. Sampson Ugorji, a licensed appraiser in Maryland, was often used by Beeman and Deursch to appraise properties. He is one of the individuals who has been indicted in this case. On all appraisal forms there is a section that requires the appraiser to disclose if the property was sold within the last 12 months. The clause was specifically designed to prevent the situation that we find ourselves in today. Appraisers are failing to disclose that many of the properties have been sold within the last 12 months.
- The last phase of the scam is the property settlement. Attorneys who specialize in property transactions often head settlement companies. In many settlements involving flipped properties, the buyer questioned certain data on the HUD 1 Form. This form documents all details of the particular real estate transaction. The accuracy of the HUD 1 is imperative in disclosing the true facts of the transactions to the lenders and government agencies. The settlement attorney assures the buyer that the transaction is legitimate and that the higher contract prices were only for “financing purposes.” The buyers give great weight to the information provided by the settlement attorney because they believe the lawyer is working in the buyer’s best interest. The settlement attorney furthers the fraud by sending correspondence to the lender saying a down payment has been made; by signing off on false value information provided on the HUD 1; by not disclosing information about the “arms’ length” of the transactions, or by lying to the buyers. Mailings of the HUD 1 forms have been used as counts in the indictment in the Beeman case.

WEAKNESSES IN THE EXISTING PROCESS

There are several weaknesses in the real estate process that require attention. The public needs to be aware of them and change needs to be considered. Some of the pitfalls we have seen are:

- Many of the flippers are not licensed real estate agents or brokers. In essence, anyone can perform these real estate transactions in an unregulated environment. This is very disturbing considering that they have made thousands of real estate transactions without appearing on the radar screen of any state regulators.
- Appraisers are licensed after completing a test and spending 2,000 hours with a licensed appraiser. The majority of the appraisers that we’ve seen do not per-

form appraisals on high-value property. There is no formal review by any regulating agency. It appears that once licensed, they are not evaluated or regulated. In the absence of a subpoena, there is no way to track the appraiser to determine if they have been involved with other flippers or to learn about properties they have appraised.

- State and local government should develop a database of transactions to allow for a review of fraudulent or suspicious real estate transactions. One such program could signal authorities when a property sale is unreasonable for a specific neighborhood. For example, a computer program could track property values, and if a settlement reports a higher-than-average sales price for the neighborhood, the computer would flag the transaction for further review.
- The database could also be used to determine if some of the same flippers purchased multiple properties from HUD. This could assure the public that HUD is not being used unwittingly in supplying houses to the flippers. It may also be a tool to identify potential flippers and prevent them from purchasing houses through HUD.

CONCLUDING REMARKS

In 1999 an estimated \$3 billion was loaned for mortgages in the Baltimore area. Baltimore has an unflattering reputation of having one of the highest default rates for mortgages in the country. We estimate that at least 75 percent of the mortgages are sold in a secondary market. Often the mortgages are sold without recourse. Simply stated, a company purchases a mortgage note from a mortgage-lending company, and if that mortgage should go into default for any reason, they simply cannot recover their loss. Our Inspectors have interviewed officials in these companies who have told us that the vitality of the company has been jeopardized due to the flipping epidemic. They have echoed a concern that mortgage companies may not want to touch any mortgage business in Baltimore due to the flipping problem.

Many buyers that Postal Inspectors have encountered in this investigation were forced to default on their loan and walk away from the house. It should be noted that, for many of these victims, this was their first home. They hoped it would be their dream home. Unfortunately, for many it has turned out to be their worst nightmare.

If you take a walk on North Washington Street or Rose Street, you will see many vacant and boarded-up homes. Dig a little further and you will learn that at least one third were involved in a “flip” transaction of one fashion or another. Then keep in mind that the flippers are purchasing the houses from HUD and auction due to foreclosures. We believe that if prompt action is not taken soon, we will see the second generation of flipping in the city of Baltimore within a year.

The Postal Inspection Service will continue to provide investigative resources to this problem. However, additional prevention efforts are needed to keep homebuyers from becoming victims and to keep Baltimore from continuing the downward spiral in the mortgage business. Again, I would like to extend my appreciation to the Committee, Senator Mikulski and Senator Sarbanes for the opportunity to discuss this problem today. I would be happy to respond to any questions that you have at this time.

Senator MIKULSKI. Thank you, Mr. Rowan. Thank you, Ms. Battaglia and Mr. Mosquera. Let me say, first of all, that we are very proud of you and very proud of the job you have done on this. And in another forum, we want you to have the tools that you need to continue this vigorous investigation and your counterparts on the other task forces continue do so.

Today is not a discussion on the need for your resources, but we want to send a message to the flippers, loud and clear: We are coming after you and we are coming after you with every tool the Federal Government has. And we intend to back our promises with an appropriation that matches the need to this very labor-intensive work. And we want to do this not only in Baltimore but in all the other places where this virus is starting to spread. So we want very much to hear from you, Ms. Battaglia. We know that you will be able to guide us in what you need, as well as the need for the FBI and for the Postal Service. But we want you to have what you need to be able to go after these flippers.

And this then takes me to my first question, which goes to you, Ms. Battaglia. This is a despicable practice. Flipping is despicable. But the question is, is it illegal? Could you share with me, number one, what are the crimes being committed, or where do you believe crimes have been committed where flipping occurs? And what are the penalties both in terms of prison and fines in this area?

Ms. BATTAGLIA. Well, there is a number of different types of crimes that are committed. But the paramount one is mail fraud. And that is why the Postal Service has been so active in that arena. Also, in terms of false statements to the government, in terms of anything that HUD was involved in or VA or FHA, but the primary tool that we use is the mail fraud statute. And the fine for the mail fraud statute is \$250,000 and 10 years in prison.

You should know, though, that in terms of this, we also are reliant on the sentencing guidelines. Because, as you know, one of the things a flipper should know is that there is no parole in the Federal system. So when somebody is sentenced to a substantial term in prison, which we are aggressively pursuing in these cases, they will serve all of the time in a Federal prison.

Senator MIKULSKI. Well, this is interesting. And, again, in the interest of time, I am not going to pursue it. But a 10-year prison sentence is a pretty stern prison sentence. But these are white collar crimes and they are going to have a lot of fancy lawyers, because they are making a lot of money. And so they are going to weasel and whine and wiggle to get out of a prison sentence. A \$250,000 fine is minuscule compared to the lucrative profits made in this gouging.

And I would like to discuss with you, separately from this, what you or other U.S. attorneys or where I should turn for really increasing the penalties for this. Also, again, does this violate RICO standards? Now, since we hear they sit around restaurants and collude and cooperate with each other, is this a new form of organized crime? I would really welcome your advice and insights on this. And perhaps we could look forward to a private conversation.

Ms. BATTAGLIA. Let me also say, Senator, that there are also mandatory restitution guidelines that may be appropriate in these cases. One of the things we should note, though, is that oftentimes white collar criminals engage in what I call wine, women and song, and basically disperse their funds not only offshore but basically limit the amount that is available to the Federal Government for seizure in forfeiture issues or in mandatory victim restitution.

Nevertheless, with some of the new statutes that Congress enacted, especially 18 U.S.C. Section 1345, where we have the opportunity, we try to freeze assets.

Senator MIKULSKI. That is a very good suggestion.

Mr. Mosquera, first of all, I am going to go to the post office. Are you also investigating the wire fraud part of this or is it the FBI?

Mr. ROWAN. We work it in conjunction with the FBI or any other agencies involved in the task force. But we investigate that, as well, through Ms. Battaglia's office.

Senator MIKULSKI. I see. And how many inspectors do you have working on the Baltimore case?

Mr. ROWAN. In the Baltimore case, we have two inspectors assigned to the task force for the City of Baltimore.

Senator MIKULSKI. And do you feel that both the law and the penalties are adequate?

Mr. ROWAN. I feel that they are. These are very time-consuming investigations, which is the problem we run into.

Senator MIKULSKI. So it takes a lot of work and it is a lot of paperwork to sift through?

Mr. ROWAN. Yes.

Senator MIKULSKI. And, really, we call it the new crime for the new economy. This is not your J. Edgar Hoover's FBI anymore. It is a lot of accountants. And it is not everybody in tan raincoats, running down alleys. Not that that was bad.

Mr. MOSQUERA. I do not recognize a lot of what we do these days.

Senator MIKULSKI. It requires new skills and it is also very labor intensive. It is really business accounting and managerial to do that. But, either way, it takes sitting down and going through each slip of paper, each settlement sheet, and so on, to see the pattern and practice involved here.

Mr. ROWAN. It is. And once you identify at what point that they break, you can then start focusing on that point and working the investigation from there.

Senator MIKULSKI. What about you, Mr. Mosquera, where do you think is the point that we should intervene here in terms of prevention?

Mr. MOSQUERA. Well, I think there has been some comments about regulating the appraisers, the mortgage lenders. From our perspective, it would be in the resource enhancement. And, again, we can get into that later on. The FBI has taken, our approach to this crime problem, we are in the process of analyzing the database here in Baltimore, of 13,000 properties sold between 1997 and 1999 that were bought and sold in less than a 90-day period. From there, what we have done is we have basically prioritized the most egregious ones. And we set a threshold of over 300 flips, properties bought and sold in the same day.

So, again, we are looking at those areas. We have this through the appropriations that were given through the housing fraud initiative. The FBI has received some of those funds. And that is what we have done with some of the money here in Baltimore. We have two full-time investigators assigned to the HUD task force. We have a two additional investigators, one from our headquarters in Woodlawn and one in our Calverton office to look at this.

For the whole State and throughout the whole FBI, we are appropriating nine agents and two financial slots. But, again, it is kind of like the field of dreams, hoping they will come, I think the more we uncover. However, I think this is probably a finite problem. I think, given the notoriety this is getting, I think Baltimore, in particular, hopefully will turn around.

It is interesting, you mentioned organized crime before. One of our agents was visiting an out-of-state lender the other day and he made the comment that Baltimore is like the John Gotti of flipping. I assume he was drawing an analogy between how notorious John Gotti was in his heyday to the way Baltimore is right now. But I believe, again, the approach we are taking, through law enforcement and through the legislation, that we are turning the corner on this problem.

Senator MIKULSKI. Just one other question for Mr. Rowan. What I would really appreciate is, one, the resources we need to really pursue this here, but then where, through your work with your counterparts in your agencies and various other parts of the country, what are the other top two or three areas that are the John Gotti of flipping's family. Because if we are not going to go nationwide—and we are nationwide, but I venture from what I have heard in your testimony and other sources, there are like three areas that you are really going to go after.

Like any virus, we want to stop its spread. And the fact is you are building up an expertise. So if you are building up these around the country, we know you will be able to move in quickly because of the tremendous expertise you have developed in these very high-profile areas. But, Mr. Rowan, you also recommend changes in the appraisers.

Mr. ROWAN. The appraisers is the key point, because it is such an important element, and reporting any arm's length relationship and giving a good assessment on the value of the home. If they were working in cahoots with the broker in this case or the flipper, they are going to try to meet their expectations. More independent appraisals will help fix that problem.

Senator MIKULSKI. Senator Sarbanes.

Senator SARBANES. First of all, I want to be clear with Lynne Battaglia, what is the range of penalties for the various crimes you are looking into?

Ms. BATTAGLIA. Well, remember, we are talking about generally a 10-year term, Senator Sarbanes. However, the sentencing guidelines, there are Federal sentencing guidelines that determine the ultimate sentence based upon the offense record of the individual and the loss that a person or a group of persons incurred. So it depends upon how much the loss is and whether the person had a criminal history.

In white collar crimes, the situation generally is that the defendant or the perpetrator does not have a prior criminal history in most instances. However, the loss in these circumstances is relatively high, so you are looking at a situation where we are going to be asking for jail time in these situations, albeit, generally, in white collar cases we never see a 10-year period, even if the maximum sentence is 10 years, as you know.

Senator SARBANES. Presumably, though, the guidelines encompass a prison sentence that is within the parameters of the guidelines; is that correct?

Ms. BATTAGLIA. Yes.

Senator SARBANES. So the guidelines are not such that the penalty gets reduced down to a fine and mandatory restitution; it would still encompass, even if it is less than the maximum of 10 years, it would still encompass, I would imagine, a substantial jail sentence. Would that be correct?

Ms. BATTAGLIA. That is correct, Senator. And what we have found is, over the last few years, in white collar cases, we have gotten substantial jail time.

Senator SARBANES. Now, you are in a position, of course, to recommend to the court, presumably, your own thinking about the nature of the penalty that should be involved. Even though some of

these people may not have a prior criminal record, the harm they have done is sort of manifest, where here you actually saw the victims earlier and heard their testimony. So presumably, from a prosecutor's point of view, a jail sentence is a reasonable part of the punishment for this kind of an offense. Would that be correct?

Ms. BATTAGLIA. Absolutely, Senator. What we have found is, through the aggressive efforts of the FBI and the Postal Service, we have been able to amass data in this arena that helps us build the case for a jail sentence. And we do recommend it and intend to recommend jail in these circumstances.

Senator SARBANES. Now, let me ask about the task force that has been set up. That task force applies to the entire State, does it not?

Ms. BATTAGLIA. Yes, it does.

Senator SARBANES. So those areas where you indicated earlier, outside of Baltimore, where you thought this problem was now germinating, so to speak, would be subject to the work of the task force; is that correct?

Ms. BATTAGLIA. That is correct. And as the Senator knows, we have a Southern Division with a new Federal courthouse, where we house 17 assistant United States Attorneys, who are involved in investigating and prosecuting mortgage flipping.

Senator SARBANES. Now, who else is in on that task force? If you could give us the composition of the task force.

Ms. BATTAGLIA. Well, let me tell you, there are two different types of task forces. We have a U.S. Attorney run task force, which coordinates all of the activities, or hopefully coordinates all of the activities in this arena. And we coordinate of course with the State Attorney General's office, with the Postal Inspection Service, with the FBI, and any other actor that is involved in investigating fraudulent activity. So you can have different types of people or different types of agencies come in and out. HUD may be involved if it is somehow related to HUD, as well as any of the other agencies.

Mr. Mosquera mentioned the HUD task force that was funded through appropriations through HUD, which has of course HUD as the major actor. We do not coordinate that task force. We are an actor on that task force.

Senator SARBANES. Now, I understand you said you had the State Attorney General involved on the task force. I think that is very important, because the regulation of some of these activities has traditionally been primarily done at the State level. And of course we are going to be hearing from three very able members of our General Assembly, who are focused on that very issue. But I think it is obviously important that the State law enforcement people be included as a part of your task force.

Ms. BATTAGLIA. Absolutely. And the City people can be involved also. We have some really excellent people in the City who are aware of this. And of course, although we cannot have activist groups as a part of the task force because of the issues that involve grand jury secrecy, I have to say that SECO and all of the other agencies you have already heard from, as well as the people who brought this to our attention, have been instrumental in basically not only encouraging involvement from all of the other actors but bringing us information that has been instrumental in dealing with these issues.

Senator SARBANES. Well, I just want to commend you and Dick Mosquera and Jim Rowan for this cooperative effort you have put together. I think it is extremely important that our agencies be working in tandem, as you are now doing, and that considerable resources are being put into this effort. So I think it is sending a very, very strong signal. And obviously you have our backing to the full.

Thank you.

Senator MIKULSKI. Thank you, Senator Sarbanes.

I, too, want to just reiterate my thanks to all three of you for what you are doing. Our colleague, Congressman Cummings, is holding a hearing in another part of the City on the issue of drugs and how are we going to clean up the streets and get people to help meet their needs. And this goes to the kind of work you are doing, whether it is fighting drugs, money laundering, the despicable use of the Internet to lure children into predatory situations, and children's exploitation, which I know you have been involved in fighting.

And my predecessor, Senator Mathias, worked with you over the years. So you are doing many, many things to serve the Nation and to protect our community, from terrorism to predators. And we want to thank you for it. And we really found this testimony very valuable and very insightful, and we look forward to making sure you have the resources. Because, again, we are going to just say to the flippers: We are here.

In other words, this is not a photo op. We are here. You are there every day in the trenches, doing your investigation, and we are there in the Senate, in the trenches, making sure you have the tools that you need. So if you are a flipper, get out of the business today. If you think you are going to be a flipper, do not even think about it and do not even go there, because we will be coming after you.

So thank you. And, again, our heartfelt appreciation.

Ms. BATTAGLIA. Thank you.

Senator MIKULSKI. Now, let us turn to the members of the General Assembly, who have been very active in this: Delegate Carolyn Krysiak, Delegate Sandy Rosenberg, and Delegate Maggie McIntosh. We also want to acknowledge the very excellent work of the members' research team in Annapolis. I have here the background paper done by the Department of Legislative Services, the Office of Policy Analysis, for the Maryland General Assembly, outlining the problem. In correspondence to you, Delegate Rosenberg, and you, Delegate Krysiak, this is such an excellent summary of the issues and the statutes, both State and Federal, that are violated. I would like to enter this into the record, because it is an excellent briefing and tutorial.

[The information follows:]

DEPARTMENT OF LEGISLATIVE SERVICES,
OFFICE OF POLICY ANALYSIS,
MARYLAND GENERAL ASSEMBLY,
SEPTEMBER 17, 1999.

Hon. SAMUEL I ROSENBERG
733 West 40th Street, Suite 105,
Baltimore, Maryland 21211.

Hon. CAROLYN J. KRYSIAK,
364 Cornwall Street,
Baltimore, Maryland 21224.

DEAR DELEGATE ROSENBERG AND DELEGATE KRYSIAK: We are writing in response to your request to review the issue of real estate “flipping”, and to suggest appropriate legislative remedies, if any.

THE PROBLEM

Real estate or property “flipping” is the practice in which distressed houses are bought very cheaply and then resold for inflated amounts by the use of an inflated appraisal to support a loan for a buyer. Although several variations of this practice exist, a typical scenario involves an unsophisticated buyer with limited resources, a poor credit history, and a strong desire to own his or her own home. The seller offers the buyer, who is unable to secure conventional financing, assistance in obtaining a loan. This is accomplished by use of a fraudulent loan application and fraudulent property appraisal. Once the buyer closes, the buyer has difficulty paying the mortgage and is unable to refinance because of the inflated original mortgage. The buyer is then forced to default on the mortgage.

BUYING A HOME

In a typical residential real estate transaction, after negotiating the sales price and other terms of the sale, the buyer and seller sign a contract of sale that, among other things, states the purchase price that the parties have agreed on and provides that settlement will take place within a specified time period, usually 45 to 60 days. The contract will often include several contingencies, e.g., a home inspection contingency that makes the contract contingent on the receipt and approval by the buyer of a structural and mechanical inspection of the property and/or an environmental inspection and a financing contingency that makes the contract contingent on the buyer obtaining a written commitment for mortgage financing. Under a standard home inspection contingency, if the home inspection reveals significant and material defects, the buyer can rescind the contract unless the seller agrees to make the necessary repairs. However, a buyer in a “flipping” scheme relies solely on the seller’s statements regarding the condition of the house. Additionally, not only is the buyer unaware of his ability to write into the contract a home inspection contingency, the buyer probably cannot afford to pay a home inspector.

During the 45 to 60 days that the contract is held open, the buyer will apply for a mortgage loan. In a typical process, if the buyer is approved for the loan, the lender will lock in an interest rate for a certain number of days, usually no longer than 30 days. During this time, the lender may ask the buyer for additional information regarding income, credit report, etc. As part of the loan process, a lender requires an appraisal to assess the fair market value of the home, in order to assure that there is sufficient value in the property to secure the mortgage loan. The buyer essentially pays for the appraisal through fees in connection with the loan. However, the buyer generally does not receive a copy of the appraisal for review.

Once the lender approves the loan, the lender will send notice to the buyers attorney or title insurance company to schedule settlement. At this point the attorney searches the title to the property to assure that there aren’t any outstanding liens or defects in the title.

Finally, if the buyer is approved for financing, is satisfied with the home inspection, and title is clear, settlement will occur.

MARYLAND LAW RELATING TO REAL ESTATE “FLIPPING”

Maryland law establishes a number of requirements applicable to sales of real property. Some of the pertinent provisions are discussed below.

Disclosure or Disclaimer Statement

Section 10-702 of the Real Property Article requires that the seller of single family residential real property complete and deliver to the purchaser either a property condition disclosure statement or a disclaimer statement stating that the seller

makes no representations as to the condition of the real property and that the purchaser will be receiving the property “as is.”

Presumably, in a flipping transaction, the seller completes a disclaimer, rather than a disclosure, statement.

Notice of Buyer’s Right of Selection

Section 17–524 of the Business Occupations and Professions Article requires that each real estate contract submitted to a party by a real estate broker, an associate real estate broker, or a real estate salesperson for use in the sale of a single-family dwelling contain, in bold-faced type, a statement that the buyer has the right to select the buyers own: (1) title insurance company, (2) settlement company, (3) escrow company; (4) mortgage lender; or (5) title lawyer.

However, in most flipping transactions, the seller markets directly to the buyer; since there is no real estate broker involved, this requirement would not apply.

Real Estate Appraisers

The provisions of law governing real estate appraisers are contained in Title 16 of the Business Occupations and Professions Article. Under § 16–101(b) of the Business Occupations and Professions Article, an “appraisal” means “an analysis, conclusion, or opinion about the nature, quality, utility, or value of interests in or aspects of identified real estate.” An appraisal includes a valuation appraisal, an analysis assignment, and a review assignment. In Maryland, there are two types of appraisers: certified and licensed. A “certified real estate appraiser” means an individual who is certified by the State Commission of Real Estate Appraisers (the Commission) to provide certified real estate services. A “licensed real estate appraiser” means “an individual who has a license issued by the Commission to provide real estate appraisal services.”

According to the regulations, the main difference between a licensed and certified real estate appraiser is the amount of education and appraisal work experience. A current applicant for a license must complete 90 classroom hours of study and have 2,000 hours of appraisal work experience, while an applicant for certification must complete 120 classroom hours and 2,500 hours of appraisal work experience for residential appraisals and 180 classroom hours and 3,000 hours of appraisal work experience for general appraisals. COMAR 09.19.0203 and 09.19.03.01.

However, the Commission requires licensing and regulates only those individuals who provide real estate appraisal services for federally related transactions. Therefore, the majority of residential real estate transactions do not require that a licensed or certified appraiser perform the appraisal services.

The Commission may deny a license or certificate, reprimand any licensee or certificate holder, suspend or revoke a license or certificate, or impose a fine of not more than \$5,000, if the applicant or licensee or certificate holder fraudulently or deceptively uses a license or certificate. Additionally, a licensee or certificate holder may not commit an act or make an omission in the provision of real estate appraisal services that is an act of dishonesty, fraud, or misrepresentation if the licensee or certificate holder intends to benefit himself or another person substantially or to injure substantially another person. A licensee or certificate holder is also subject to disciplinary action for failing to exercise reasonable diligence or for committing negligence or incompetence in developing, preparing, or communicating an appraisal. See § 16–701(a) of the Business Occupations and Professions Article.

Mortgage Brokers

A “mortgage broker” is a “person who for a fee or other valuable consideration, whether received directly or indirectly, aids or assists a borrower in obtaining a mortgage loan and is not named as a lender in the agreement, note, deed of trust, or other evidence of the indebtedness.” Mortgage brokers are licensed by the Commissioner of Financial Regulation under Title 11, Subtitle 5 of the Financial Institutions Article. A license issued by the Commissioner authorizes the mortgage broker to act as a mortgage lender. Under § 11–517 of the Financial Institutions Article, the Commissioner may suspend or revoke a mortgage broker’s license if “in connection with any mortgage loan or loan application transaction, the mortgage broker commits any fraud, engages in any illegal or dishonest activities, or misrepresents or fails to disclose any material facts to anyone entitled to that information.”

In order to enforce these provisions, the Commissioner may also issue a cease and desist order and an order requiring the violator to take affirmative action to correct the violation, including the restitution of money or property to any person aggrieved by the violation. If a mortgage broker fails to comply with an order, the Commissioner may impose a fine of up to \$1,000 for each violation. Finally, if the Commissioner discovers that a business is violating or evading any rule or regulation adopt-

ed under this subtitle or any law regulating mortgage loan lending, the Commissioner may issue a written order to stop doing business.

Additionally, § 11-523 of the Financial Institutions Article contains criminal penalties. Any person who willfully violates this subtitle, or any rule or regulation adopted under it, is guilty of a misdemeanor and on conviction is subject to a fine not exceeding \$5,000 or imprisonment not exceeding one year or both. A mortgage broker who “willfully misappropriates or intentionally and fraudulently converts to the mortgage broker’s or to the mortgage broker’s employee’s or agent’s own use moneys in excess of \$300 rightfully belonging to a borrower, or who otherwise commits any fraudulent act in the course of engaging in the mortgage lending business is guilty of a felony and on conviction is subject to a fine not to exceed \$100,000 or imprisonment not exceeding 15 years or both.”

Consumer Protection Act

The Maryland Consumer Protection Act prohibits a person from engaging in any unfair or deceptive trade practice in: (1) the sale, lease, rental, loan, or bailment of any consumer goods, consumer realty or consumer services; (2) the offer for sale, lease, rental, loan, or bailment of consumer goods, consumer realty, or consumer services; (3) the extension of consumer credit; or (4) the collection of consumer debts.

The Division of Consumer Protection in the Office of the Attorney General may issue an order requiring a person found to have violated the act to cease and desist from the violation and to take affirmative action, including the restitution of money or property. The Attorney General may also seek an injunction to prohibit a person who has engaged or is engaging in a violation of the act from continuing or engaging in a violation. In addition, any person may bring an action to recover for injury or loss sustained as a result of a practice prohibited by the act. A person who is awarded damages in such an action may also be awarded reasonable attorney’s fees.

Violations of the act are also subject to criminal penalties. A person who violates any provision of the act is guilty of a misdemeanor and on conviction is subject to a fine not exceeding \$ 1,000 or imprisonment not exceeding one year or both.

Other Remedies

Most of the lawsuits that have been filed as a result of these “flipping” scams allege fraud, conspiracy to defraud, and unfair or deceptive trade practices. The elements of common law fraud are that:

- that the defendant made a false representation;
- that its falsity was either known to the defendant or the misrepresentation was made with such reckless indifference to the truth as to be equivalent to actual knowledge;
- that it was made for the purpose of defrauding the person claiming to be injured thereby,
- that the injured person not only relied upon the misrepresentation, but had a right to rely upon it in the full belief of its truth, and would not have done the thing from which the injury had resulted if the misrepresentation had not been made; and
- that the person actually suffered damage directly resulting from, such fraudulent misrepresentation.

FEDERAL LAW RELATING TO REAL ESTATE FLIPPING

Criminal Charges

Participants in flipping schemes can be charged with various crimes, depending on the circumstances of the situation and the available evidence. In *U.S. v. Cassiere*, 4 F.3d 1006 (1st Cir. 1993), three defendants were convicted of wire fraud, aiding and abetting wire fraud (18 USC § 1343), and conspiracy to commit wire fraud (18 USC § 371) in connection with a real estate flipping scheme and sentenced to between 24 and 46 months imprisonment. The elements of wire fraud are: (1) a scheme to defraud by means of false pretenses; (2) the defendant’s knowing and willful participation in the scheme with the intent to defraud; and (3) the use of interstate wire communications (e.g., telephones, fax) in furtherance of the scheme.

In *U.S. v. Aubin*, 87F.3d 141(5th Cir. 1996), a defendant in a flipping scheme was convicted of wire fraud, conspiracy to defraud the United States (18 USC § 371), and bank fraud (18 USC § 1344). The defendant was sentenced to five years imprisonment and ordered to pay nearly \$44 million in restitution in connection with the bank fraud count.

In *U.S. v. Chavoux*, 3 F.3d 827 (5th Cir. 1993), the defendant was convicted of conspiracy to defraud the United States, attempted tax evasion (26 USC § 7201), and filing false tax returns (26 USC § 7206(1)) in connection with a real estate flip-

ping situation. The tax charges arose out of the defendant's failure to report the income from the flipping on his tax returns. He was sentenced to 33 months in prison.

Real estate flippers could also be charged with mail fraud (18 USC § 1341 *et seq.*)

The Racketeer Influenced and Corrupt Organizations Act (18 USC § 1961 *et seq.*) basically prohibits organized crime. Violators of RICO are subject to criminal conviction, significant fines and imprisonment, and forfeiture of money and other property obtained pursuant to the violation. Injunctive relief is also available. In addition, victims may sue under RICO. Treble damages and attorney's fees are recoverable. The Department of Justice can also institute civil proceedings under RICO.

The Federal Trade Commission Act (15 U.S.C. § 45–48)

Under this act, the Federal Trade Commission (FTC) is empowered, among other things, to: (1) prevent unfair methods of competition, and unfair or deceptive acts or practices in or affecting commerce; (2) seek monetary redress and other relief for conduct injurious to consumers; (3) prescribe trade regulation rules defining with specificity acts or practices that are unfair or deceptive, and establishing requirements designed to prevent such acts or practices; (4) conduct investigations relating to the organization, business, practices, and management of entities engaged in commerce; and (5) make reports and legislative recommendations to Congress.

Section 5 of the FTC Act is a broad anti-fraud statute similar to state consumer protection acts. The FTC enforces § 5, focusing mainly on the issue of whether material misrepresentations were made. Although it generally pursues § 5 actions only if there is a pattern of fraud across state lines, the FTC is not prohibited from pursuing cases arising out of purely intrastate schemes. Injunctions and other equitable relief (such as disgorgement) are available under § 5, as well as civil penalties.

Truth in Lending Act (15 USC § 1601 et seq.)

The Truth in Lending Act (TILA) is essentially a disclosure statute. It requires creditors who regularly extend consumer credit to disclose essential credit terms, especially the costs of obtaining the credit, before the credit is extended. Residential real estate sales are subject to TILA. "Regulation Z" is a comprehensive set of regulations enacted pursuant to TILA.

The following agencies are charged with enforcing TILA:

- Comptroller of the Currency (as to national banks);
- Federal Reserve Board (as to non-national member banks);
- Federal Deposit Insurance Corporation (as to insured banks that are not members of the Federal Reserve System);
- Federal Home Loan Bank Board (as to savings institutions not insured by FDIC)
- Bureau of Federal Credit Unions (as to federal credit unions); and
- Federal Trade Commission (as to other lenders).

These agencies may seek injunctive relief and/or civil penalties against violators of TILA.

In addition, § 1611 of TILA makes it a crime for a creditor to willfully and knowingly give false or inaccurate information or to fail to make disclosures required by the act. Violators are subject to a fine of up to \$500 and/or imprisonment of up to one year. These cases are prosecuted by the Department of Justice. However, few of these cases are apparently pursued due to lack of resources.

Section 1640 of TILA creates a private right of action for consumers aggrieved by a violation of the act. Prevailing plaintiffs can recover actual damages, statutory penalties (approximately twice the amount of the finance charge in question), and attorney's fees.

However, TILA is of limited value in addressing the flipping problem for a number of reasons. First, the remedy of rescission for improper disclosure does not apply to purchase money mortgages. Second, as long as the calculation of the numbers contained on the forms is correct, the damages remedy doesn't apply. In addition, TILA only applies to lenders. Therefore, this act wouldn't apply to a flipping transaction unless the creditors had knowledge, which isn't really being alleged. It would be more likely that a local lender would have knowledge, since a local lender would be familiar with the neighborhoods where the properties are located and should know if an appraisal is inflated.

Real Estate Settlement Procedures Act (12 USC § 2601 et seq.)

The Real Estate Settlement Procedures Act (RESPA) protects buyers and sellers of residential real estate from unreasonably high settlement costs by requiring advance disclosure and outlawing certain kickbacks. Virtually all mortgage lenders taking a first lien on residential real property are covered. RESPA requires that when someone applies for a federally regulated mortgage loan, the lender must deliver to the applicant a copy of a HUD special information booklet to explain the nature and costs of real estate settlement services. The lender must include a good

faith estimate of settlement charges. RESPA also provides that a seller may not require a buyer to purchase title insurance from a particular company, prohibits kickbacks and unearned fees, limits advance deposits in escrow accounts, and prohibits lenders from charging fees for the preparation of disclosure statements that RESPA and TILA require.

RESPA also only applies to lenders. Unless there were referral fees or kickbacks (i.e., for bringing in business), buyers can't pursue lenders under this statute. Referral fees and kickbacks would be more likely in the case of an out-of-state lender, since local lenders would be more likely to be able to generate their own contacts.

Recommendations

After reviewing the current federal and state statutory provisions concerning the practice of property "flipping" and speaking, with the various concerned parties, the department makes the following key recommendations: (1) more aggressive enforcement of existing laws; and (2) increased public-awareness efforts to educate prospective buyers, mortgage lenders, mortgage brokers, and appraisers about property "flipping" and other similar fraud schemes. However, certain legislative changes should be considered that may help limit the occurrence of property "flipping."

Counseling for First-Time Home Buyers

Several legislative proposals have been offered by individuals familiar with property "flipping" occurring in Baltimore City most notably improving consumer awareness of "flipping" and other related schemes by requiring counseling for first-time home buyers. Several individuals contacted by the department believe that educating the consumer is the first step in ridding the City of these fraudulent housing deals.

There are approximately 20–25 housing counseling agencies across the State. The Maryland Center for Community Development (MCCD) provides housing counseling training. Becky Shareblom, the Executive Director of MCCD, said that the organization makes approximately 300–400 referrals a year to counseling agencies across the State. The training manual for the housing counselors provides a detailed description of the information they provide during a counseling session.

During the first visit with a buyer, a counselor will ask about the buyer's income and credit history, why the buyer wants to own a house, and what the buyer sees as the benefits of becoming a homeowner. If necessary, the counselor will work with the buyer to clean up or establish credit or develop a savings plan. The counselor will also explain the various types of financing, including fixed rate and adjustable rate. Finally, if the buyer does not know during the first visit where he or she wants to purchase a home, the counselor is required to provide the name of at least three to five real estate agents. The counselor will also provide the buyer with a list of questions to ask the real estate agent so that the buyer can make an informed decision.

Sometimes a buyer will come back to the housing counselor with a pre-approved loan for an explanation of the next steps towards securing a loan. The counselor would then advise the buyer to get a home inspection, the need for an appraisal, and any additional information helpful to the buyer.

As long as the buyer keeps coming back through the various stages of the home buying process described above, the counselor will provide guidance. In rare cases the counselor has even gone to settlement with the buyer. Although the counselor is trained to strictly provide information, the counselor will question a buyer or alert a buyer if a part of the transaction is a concern. For example, an extremely low or high appraisal is something to discuss with the buyer.

Requiring a first-time home buyer to submit a certificate of housing counseling at either the contract stage or the loan stage is feasible. Because the counseling goes through every step in buying a home, perhaps requiring the counseling at the initial stage would be preferable.

However, although many first-time home buyers would benefit from a counseling program, many others do not need such assistance and, therefore mandating counseling may be burdensome. Furthermore, mandating unnecessary counseling for thousands of home buyers it could strain existing counseling resources. The department recommends that methods of increasing consumer awareness through education be studied while considering less intrusive legislation. For example, a pending regulatory change in New York would require a lender or mortgage broker to disclose to the borrower at the time of the application that the borrower should consider counseling. This would help steer those first-time buyers who read counseling to those resources without a statutory mandate.

Home Inspections

Many individuals familiar with “flipping” agree that requiring home inspections would greatly minimize the problem. In a typical contract, a buyer will include a home inspection contingency and a financing contingency. However, the unsophisticated buyer purchasing a “flipped” property is generally unaware of this common practice.

A home inspection involves going inside the home to look at the actual structure and engineering of the house. An appraisal does not involve going inside a house, but is based on the prices for which similar houses in the same area have recently sold. Under § 12–121 of the Commercial Law Article, the lender is not allowed to impose a lender’s inspection fee unless needed to ascertain construction of a new home or repairs or alterations required by the lender. This section could be amended to allow a lender to impose an inspection fee when the lender is approving a loan for a first-time home buyer. While the buyer would ultimately pay for this inspection, the fee would be included in the loan and the inspection would be concluded prior to signing the loan agreement.

Mandating a home inspection as part of a real estate contract or mortgage application would likely require licensing or registration of home inspectors by the Department of Labor, Licensing, and Regulation. Legislation during the 1999 Session regarding the licensure or regulation of home inspectors received unfavorable reports by the House Economic Matters Committee and the Senate Economic and Environmental Affairs Committee.

Real Estate Appraisers

The Maryland Real Estate Appraisers Commission requires licensing and regulates only those individuals who provide real estate appraisal services for federally related transactions. For loans lacking a federal component, the services of a licensed or certified real estate appraiser are not required. Therefore, the Commission has no authority to regulate these individuals. Because of the significant role played by appraisers in “flipping” scams, the department recommends that the legislature consider requiring licensure or certification for all real estate appraisers. In addition, the penalties provided under current law could be increased to further discourage fraudulent acts by appraisers. Under current law, the Commission is limited to reprimanding any licensee or certificate holder, suspending or revoking a license or certificate, or imposing a fine of not more than \$5,000. To aid the Commission in regulating these additional licensees and certificate holders, funding for the Commission could be increased to provide for an investigatory staff, which currently does not exist.

In New Jersey, the Real Estate Appraiser’s Act was amended to require criminal background checks and fingerprinting of appraisers and, with some exceptions, licensing of appraisers involved in real estate deals. *See* New Jersey Public Law 1997, Chapter 401. Under current law, the Maryland Real Estate Appraisers Commission may require fingerprinting of a license or certificate applicant, but the Commission has never done so.

Copy of Written Real Estate Appraisal

In addition, new legislation in Wisconsin also provides that if a loan applicant so requests, a mortgage banker or mortgage broker must provide the loan applicant with a copy of any written appraisal report that the banker or broker holds if the applicant paid a fee for the appraisal and it relates to the residential real estate that the applicant owns or has agreed to buy. *See* Wis. Stat. § 224.75(3)(b). Under Maryland law, a buyer must request and pay for a copy of the appraisal. *See* § 14–104.1 of the Real Property Article. Since a crucial element of these schemes is an inflated appraisal, the department recommends that the legislature consider amending state law to require that a copy of the appraisal be given to the buyer.

Disclosure of Recent Sale

In Minnesota, a bill pending before the state legislature would require sellers to disclose in the purchase agreement for one-to-four-family residential deals the estimated market value used to determine the property taxes payable in the current year and the past purchase price for any sale of the subject parcel where there had been a conveyance within the past six months. Failure to disclose would subject the seller to an action for damages. Currently, in Maryland, it takes approximately 60 to 90 days after settlement for the sale and the purchase price to appear in the tax records, making it difficult for a buyer to uncover a recent sale of the property. Furthermore, Maryland law could be amended to require the seller to disclose the previous purchase price of the house under certain circumstances. For example, if the re-sale occurs within a certain time limit, or if the buyer is a first time home buyer,

the previous price could be required to be disclosed. The department recommends that the legislature consider these changes.

Prohibit Lending Without "Due Regard to Payment"

A pending regulatory change in New York would prevent lending without "due regard to repayment ability." This change would prohibit a lender from making certain home loans unless the lender reasonably believes at the time the loan is consummated that the borrower will be able to repay the loan based upon the borrower's current and expected income, current obligations, employment status, and other financial resources (other than the borrower's equity in the dwelling which secures repayment of the loan). Similar legislation also has been introduced in North Carolina. The department recommends that similar legislation be considered in Maryland.

Modification of Loan Terms

Property "flipping" has also been a problem in Chicago. Although the Department of Housing and Urban Development (HUD) was not alleged to be a wrongdoer, the Federal Housing Administration (FHA) agreed to modify the loan terms for "flipping" victims to bring the loan amounts closer to the actual value of the homes. This action was brought about by community agitation and media attention.

Decentralizing Enforcement of Consumer Protection Act

Current law provides that the Office of the Attorney General has the sole authority to seek a cease and desist order to enjoin violations of the Consumer Protection Act. See § 13-403 of the Commercial Law Article. Although the Consumer Protection Division of the Office of the Attorney General has begun to study the "flipping" issue, it has been unable to actively pursue "flipping" scams due to a lack of manpower to pursue complaints.

The department recommends that the issue of decentralizing the power to seek a cease and desist order be explored to include the State's Attorney's Office, the Baltimore City Solicitor, or the local county attorneys.

We hope this has been responsive to your request. If you have any additional questions, please do not hesitate to contact any of us at 410-946-5510.

Sincerely,

SUSAN H. RUSSELL,
Principal Analyst.

JOHN F. FAVAZZA,
Policy Analyst.

ERIN P. DOUGHERTY,
Policy Analyst.

CLAIRE E. ROONEY,
Policy Analyst.

Senator MIKULSKI. I know each and every one of you personally. I am very proud of what you have undertaken. Delegate McIntosh, as the senior person and also chair of the Final Institutions Committee, have you coordinated how you would like to proceed?

Ms. KRYSIAK. I think I am going to start.

Senator MIKULSKI. Okay. And then who will be next?

Ms. MCINTOSH. I will be.

Senator MIKULSKI. And then, Delegate Rosenberg, you will wrap up.

Mr. ROSENBERG. I am batting ninth.

Senator MIKULSKI. Well, you represent southeast Baltimore, Delegate Krysiak, where we saw all of those blue dots and red dots, which are little dots of despair.

STATEMENT OF CAROLYN KRYSIAK, DELEGATE, MARYLAND HOUSE OF DELEGATES

Ms. KRYSIAK. Actually, I suppose, technically, most of those dots are just out of my district, but they are part of our community, and so we are seriously affected by every one of those.

I really want to thank you very much for this opportunity. It is quite an honor to do this. It is also kind of sad that we need to do this. The U.S. Attorney mentioned a couple of minutes ago the savings and loan scandal. And I have to tell you that I have very often compared these two situations. The difference, though, is that in the savings and loan scandal we had people who were injured because they had money to put into a bank. They had a little excess money and were able to save. I think the victims in this case did not ever have that opportunity. This is their lifeblood. This is their laundry money, their food money, their living money.

What is sad is that we do not see the same level of outrage. We should be outraged and the world should be outraged because of this. We have heard all the details about how these things work, so I am going to kind of stick to what it is we are trying to correct.

We have mentioned several times today the appraisers. One time we did have a mention of a real estate agent. And I did want to say, before I start, that in everything that I have heard, it is rare, the real estate agents who are fully regulated, are generally not involved in these schemes. But for the other people who are involved, there is more that needs to be done.

The appraisers, the reputable appraisers, have been begging us to demand full licensure. Their bills have failed in the past in the legislature. And I had great hopes that this year would be the year that that would be different. The house bill was doing fine, however the companion bill on the senate side died this week.

The argument is that they are federally regulated. The problem is Federal regulation has a monetary trigger that begins at \$250,000 a transaction and up. I would ask that the Federal Government please have another look at that. Because there should be the same standards for whatever the cost of the transaction. It is still the largest investment anyone makes in their lifetime, their home. And whether you can afford a \$250,000 home or a \$50,000 one, it is just as important to the individual.

On the mortgage brokers, we have several bills you will hear about that have something to do with banking practices in this State. This whole industry has had such great changes made in it that I think maybe our problem is that we have not reacted to all of the changes. For instance, we do not really license mortgage brokers. We license the mortgage lenders. The lenders act as brokers.

However, the mortgage lender can have loan initiators in an infinite number who are out there making these deals. I have a bill that has already passed the house that I expect will also pass a companion bill in the senate that will give our State regulators more strength in looking into the practices of mortgage lenders/brokers. They would have then an ability to insist that all changes in licensure become available to them immediately.

They would be able to do examinations in 18 months and repeat examinations within 3 years. There would be funding to do investigations. All of these things are needed because we have grown a number of these characters, to 2,744 licensed brokers, and God only knows how many people work for them. I would like to see how this works. If this does not work, if we are not able to keep track of these things, then I think the next step would be to make sure

that those brokers inform us as to each and every party who is out there working on that license.

In regard to the counseling, there is not legislation to deal with the counseling, but I have had many conversations—actually, we all have—at various times. And always the subject comes up to the Governor about the counseling. The way the counseling normally works now is that there are grants given to nonprofit organizations. And those nonprofits will employ housing counselors.

There are a variety of ways that these people get their expertise. And so we have been talking with the Governor and with Secretary Skinner and the Department of Housing and Community Development, trying to get a better handle on that and getting the State more involved in how that works and how we can coordinate it and how we can make it more uniform. We also talked to the Governor about the fact that the ultimate victim in this is the community. And the community fails because it is very difficult to sell a house when there are four empties on the block.

It is very difficult for the people who are living there to put up with the drug traffickers who take refuge in those empty houses or who use the condition of the community as an excuse to carry on their kind of activity. So we have talked about intervention. We already do some of that in these areas. Ed Rutkowski does a wonderful job of that.

We would like to get more money. We would like to get money based on the fact that these are neighborhoods with particular problems. In addition, we are asking the State also to take a look at their low-interest loan program and put more money into that, so that we can better aid some people and improve these neighborhoods.

In regard to the FHA inspections, just a comment. On hearing Mr. Quayle, it is a wonderful education for all of us on how those things have changed. And yet, I will tell you, from personal experience, the inspection of the FHA appraisers or FHA inspectors has not changed everywhere. In the past 2 years—actually, it is less than that—it is just a year and a couple of months—my family sold my uncle's house that was in that area that we talked about earlier. And we totally rehabbed that house, the family members did, before we put it up for sale, and still had an FHA inspector who looked at every inch of the place and found some things we had not improved.

PREPARED STATEMENT

My son sold a house last December in the Dundalk area, and was put through a lot of minor repairs, things that you would not have even seen walking through the house. And so it sort of depends a lot on what income level they are looking at maybe or what neighborhood they are looking at. But it seems that we have stricter rules for the people who can afford better. And I think we need to make sure that everything is fair for everyone and that everybody gets the same level of regulation to protect them.

And I again thank you very much for asking me here.

[The statement follows:]

PREPARED STATEMENT OF DELEGATE CAROLYN KRYSIAK

Senator Mikulski, Senator Sarbanes and members of the U.S. Senate Subcommittee on V.A. HUD, and Independent Agencies, it is an honor to testify before you today.

In recent years we have taken steps toward making the American dream of homeownership possible for greater numbers of Americans. We have opened the mortgage market, offered homebuyer incentives and assistance.

However, unscrupulous people have taken these efforts and bent them to serve their own ends. They have used them to defraud our most vulnerable citizens, the elderly, the poor and the financially unsophisticated. Indeed, the victims of mortgage fraud are mostly female heads of households. Nearly all are members of minority communities.

A few years ago the public was outraged because some Marylanders lost money in the savings and loan scandal. These were people who had deposited savings and excess income in savings and loan institutions. These were people who had some resources. Today's victims of the mortgage fraud "flipping" scam have no resources or excess income. Usually, they have excessive debt. They are unaware they are being victimized.

Unscrupulous home sellers, mortgage brokers and appraisers have lured the poor into real estate transactions by grossly misrepresenting the facts. The mortgage broker puts the pieces together. In a typical "flipping" transaction, the broker contracts with a seller of a low cost property and then finds a potential buyer. The mortgage application is falsified to make the buyer qualify for the loan. An appraiser, who agrees to evaluate the property for a price well in excess of its actual value, is enlisted in the scheme. The property is usually cosmetically disguised to hide structural flaws and plumbing and electrical inadequacies. Often the seller or the broker fulfills his contract and purchases the property on the same day that it is sold to the victim. It is not unusual for disreputable property owners to sell a house back and forth to each other to inflate the price. There are many variations on the "flipping" scam.

In Maryland we are attempting to combat this type of mortgage fraud by providing greater enforcement powers to those agencies that oversee the industries. Maryland recognizes that the ultimate victim of mortgage fraud is the community. Neighborhoods are destroyed when the "flipping" victim cannot make the payments on the home, cannot afford to repair the home and eventually, must surrender the property to the lender. The lender is unable to resell the property in settlement of the debt. The property remains vacant. Abandoned and boarded up homes are eyesores. They are open invitations for criminals and drug addicts to move in and drive out the decent neighborhood residents.

Appraisers.—While its neighboring states require licensing of appraisers, Maryland adheres to the Federal law on appraisers. Licensing is required for appraisers in transactions valued at \$250,000 or more. Licensing is strictly voluntary for transactions under that amount. Licensing is also required when a mortgage will end up in the secondary market that involves Fannie Mae and Freddie Mac, etc. This protection is insufficient. People who purchase a \$250,000 home should not be entitled to more protection under the law than people who buy a \$60,000 home. In the absence of licensing, the state has neither the enforcement powers nor the resources to investigate the \$60,000 transaction. It borders on criminal neglect to allow "flipping" to continue and some time later bring a few fraud scam artists to trial. We should not be content to think that "flipping" will end after we have made in example of a few criminals. Unfortunately, HB 768 to require the licensing of appraisers failed to gain the approval of the Senate Finance Committee.

Mortgage Brokers.—HB 1337 has received House approval, and the companion bill is expected to receive Senate approval. This measure will give the Commissioner of Financial Regulations enforcement powers necessary to monitor the ownership of mortgage broker licenses, provide regular examinations and investigations, as well as the power to apply civil penalties for infractions. Those penalties include fines and the suspension or revocation of licenses. The mortgage market has changed. No longer do we receive a loan from a neighborhood bank and make payments to that bank until the obligation has been satisfied. Today mortgages are sold and resold. Where once the State was responsible for the examination of a manageable number of financial institutions, it now must examine 2,744 mortgage brokers with the same staff.

Counseling.—We must take a good look at Housing Counseling. Such counseling should be required for all sales, involving any public money or government incentive. The counseling should include credit counseling to assure that the party is

ready to purchase a home and offer guidance on steps that must be taken to become ready.

Counseling in Maryland is done through nonprofit organizations and is often the type of guidance that might be given by a real estate agent. Currently, Maryland's Housing and Urban Development Department is looking at their program. The Department has pledged improvement and funding through department regulations.

Marketing and Education.—A coalition of real estate agents, mortgage brokers and lenders, banks, appraisers, non-profit groups and government are putting together a campaign of bus advertisement, fliers and educational opportunities. Hopefully, we can reach the public with the message; "Don't let your homebuying dream become a nightmare" and "If it seems too good to be true . . . it probably is."

Community Recovery.—In talks with Governor Glendenning, he has indicated he understands fully the impact of predatory lenders on the community. We have requested an increase of intervention buying money for Community Development Corporations and for community associations in the affected neighborhoods. We expect an increase in low interest mortgage money to be available in the threatened neighborhoods.

Victim Recovery.—A small percentage of victims will recover their losses from civil suits. State and Federal fraud suits will serve to punish the perpetrators of mortgage fraud. Hopefully, in the fraud convictions the courts will require restitution. An ideal solution would involve restructuring of loans to more accurately reflect the value of the properties.

POSSIBLE FEDERAL CHANGES

HUD Houses.—Anyone who lives in a transition area will relate that HUD-owned properties often pose a serious problem. They are not maintained. They are not sold in an acceptable and reasonable period of time. They are a wasted resource. Community Development Corporations should be able to acquire these houses more easily.

FHA Inspections.—If one sells a house in a stable neighborhood an FHA inspection is thorough. In such instances it's common for the seller to be required to repair and replace handrails, window sills, backyard cement, etc. in order to receive FHA approval. However, where "flipped" houses are concerned no such scrutiny takes place. The victimized buyer ends up with a house in disrepair with open drains, leaking roofs, dangerous electrical systems and deteriorating floors hidden beneath carpeting. Nevertheless, these homes may very well have an FHA approved loan.

Appraisers.—A Federal requirement mandating the licensure of all appraisers would go a long way toward assuring equal uniform application of the rules. I would urge you to remove the monetary trigger and treat all transactions alike.

Mortgage Brokers.—State borders do not limit lending transactions. The enforcement of the law is more appropriately accomplished at the Federal level.

Counseling.—A comprehensive program of homebuying education and counseling is imperative. It is the Federal government that has the appropriate resources to effectively accomplish such a program.

Community and Victim Recovery.—I would suggest that funds under the Community Reinvestment Act be used to stabilize communities victimized by "flipping." Individuals victimized by "flipping" should be offered greater and varied types of assistance under the Community Reinvestment Act to reduce their mortgage obligation to reflect the corrected appraisal.

I want to thank you for your attention to this issue. I appreciate the honor and the opportunity you have extended to me to appear before you today.

Senator MIKULSKI. Thank you very much.

Ms. McIntosh.

STATEMENT OF MAGGIE McINTOSH, DELEGATE, MARYLAND HOUSE OF DELEGATES

Ms. McINTOSH. Thank you, Senator Mikulski, Senator Sarbanes. It, too, is an honor for me to testify before you today. I am testifying, as I said, in my written remarks, as the Chair of the subcommittee that oversees financial institutions in the House of Delegates. That subcommittee is part of the Commerce and Government Matters Committee.

This session, probably more than any session certainly in recent history, our subcommittee and our House of Delegates has had to

deal with several issues, flipping being one of them. Predatory lending, Senator Sarbanes, has become increasingly a topic of concern. Several issues you raised earlier, also, although I will not delve into them today, payday lending and check cashing for profit—check cashing, which has also flourished in our City. Basically, what we see, at least in my estimation, is the convergence of two issues that have been talked about today.

One, we have our bank teller going from a bank teller to a bank machine. And now our bank machine is becoming an Internet service. And the question becomes, when institutions that were the anchors of our neighborhoods, the corner bank, the corner savings and loan, the corner credit union, when they leave our communities, what is left behind and what services are left behind for those who are still there? That is a policy issue we need to look at both federally and at the local and State level.

This has converged, I am afraid, with also the issue of housing and housing stock. Senator Mikulski, when I was privileged to work for you some years ago, I recall us being very concerned about what was reported at that time as over 1,000 vacant homes in this area, described today as the Little Flower and the Patterson Park area. I remember that now. The homes were not vacant as in boarded up vacant, but basically the families had moved out. The grandmother or grandfather has passed on, and the younger generation of that family was not moving in to take over that house, as had been done in generations past.

Today, sitting here, I unfortunately heard what happened to many of those homes. They became subject to folks who came in and bought up those homes and flipped them. So the convergence of both the banking and the brokerage business in this City have caused great problems.

I put a bill in that I am pleased to tell you I think filled the gap in our State regulatory area when it comes to regulating financial institutions and mortgage brokers who were involved in flipping. That bill has passed the house and I am pleased to say passed out of the senate finance committee the other day. It is a bill that addressed a problem that I believe State regulators faced when they heard early on about the flipping schemes.

Our Commissioner on Financial Regulation in Maryland had no ability, no ability even when the mortgage brokers were licensed, to go in and issue a emergency cease and desist order or to stop a transaction that they felt may be questionable. And so the bill that I introduced gives the Commissioner on Financial Regulation that ability. It also expands her investigatory powers. And it gives her civil remedies as well as the criminal remedies.

We know that with predatory lending, although not so on flipping, I think these are very large and egregious loans that have been forced on people unknowingly. But I do know that we have seen a lot of these start out in small kind of infractions that she could easily move in and impose fines and have an administrative hearing to do the kind of investigation needed. So the bill basically fills a gap that we see from flipping, from check cashing, from payday lending, in our regulatory arena. It also, by the way, calls on the Governor to appropriate the funds needed to have the investiga-

tors to do the kinds of investigation needed and to do increased enforcement.

I do want to mention, with my two colleagues sitting with me today, that I think it is one of the first times that our City delegation, chaired by Delegate Mamariotte, when the Governor came to visit, we not only talked about school construction needs, we talked about enforcement needs and we talked about regulatory needs in this area. So one of the priorities for the City delegation this year was increased funding for enforcement to look at flipping and to look at predatory lending practices in our City.

I will summarize and close by saying that it is very important for us to look at how we work together federally and at the State level to make sure we do not create big kind of holes in our regulatory system for one or the other of us to drive through. We have closed, I think, all of the gaps on check cashing, on payday lending, from the State perspective. But there is still one at the Federal level.

And on flipping, I think this is an area where we have to continue to look at, in particular, where the State can bolster the kind of regulation and enforcement that you need. And I thank you very much for allowing me to be with you today.

[The statement follows:]

PREPARED STATEMENT OF DELEGATE MAGGIE MCINTOSH

Senator Mikulski, Senator Sarbanes, and members of the U.S. Senate Subcommittee on V.A., HUD, and Independent Agencies it is an honor to testify before you today. The issue of "real estate flipping" that you have asked me and my colleagues from the Maryland General Assembly to address is a very serious one. Today, my remarks are in my capacity as Chair of the Financial Institutions Subcommittee of Commerce and Government Matters. It is from this vantage point that I have witnessed several practices, such as "flipping," "pay day lending," and the emerging "for profit check cashing services," move into predominately urban and, unfortunately, predominately poor communities. I have termed this phenomenon, "banking while poor." After listening to my colleagues, especially Delegate Carolyn Krysiak, describe how our regulatory and enforcement agencies in Maryland could not adequately address such practices as "flipping" in a timely manner, I began to look at whether our enforcement agencies had the tools to protect our citizens. The answer was no.

House Bill 727, introduced and, I am proud to say, passed by the House of Delegates, addresses a gap in enforcement powers for the Commission of Financial Regulation in Maryland. It expands the investigative and enforcement powers of the Commissioner of Financial Regulation and directs the Governor of Maryland, in the Fiscal year 2001 and each fiscal year after, to appropriate to the Division of Financial Regulation funds for the positions necessary to implement the new powers authorized under this bill. Specifically, House Bill 727 authorizes the Commissioner to make investigations to determine whether any person has violated any law, regulation, rule, or order over which the Commissioner has jurisdiction.

For the purpose of an investigation or proceeding, the Commissioner may: administer oaths, subpoena witnesses and compel their attendance, take evidence, and require the production of books and records.

When the Commissioner determines that a person has engaged in an act that constitutes a violation of a law over which the Commissioner has jurisdiction, and an immediate action is in the public interest, the Commissioner may issue, without a prior hearing, a summary cease and desist order, provided that the summary order gives notice of the opportunity for a hearing before any final action.

After proper notice and a hearing, if the Commissioner finds that the person has engaged in a violation of any law, the Commissioner may order a final cease and desist order, suspend or revoke the license, or issue a civil penalty of up to \$1,000 for the first violation and a maximum of \$5,000 for each subsequent violation. Additionally, the bill authorizes the Commissioner to seek remedies from the court. These remedies include civil fines, a temporary or permanent injunction, or restitution.

How does this differ from current powers of the Commissioner for Financial Regulation? First and most important, the Commissioner currently has no authority to issue an emergency summary cease and desist order over any licensed or non licensed person violating any law, regulation, rule, or order over which the Commission has jurisdiction. Second, the Commissioner does not presently have the ability to enforce the law in an administrative proceeding against non licensees engaging in all categories of lending within the Commissioner's jurisdiction. Currently the Commissioner can only refer violations of the consumer lending law to the Attorney General for criminal prosecution. Although that may be the final remedy, we have witnessed in the "flipping" scheme, the need for swift intervention to protect our citizens.

How will the passage of House Bill 727 allow the Commissioner for Financial Regulation to react differently in violations such as real estate flipping? Even if the mortgage broker is non licensed, the Commissioner will be able to investigate, order a summary cease and desist, and level fines. The issues in real estate flipping are complex. One of the aspects was the non licensed brokers working with property owners and appraisers to approve bogus loan packages. The Commissioner will now have the authority to stop that transaction. This legislation also allows for broader investigative authority and assessment of potential violations.

Senator Sarbanes, as you and Senator Mikulski know, the United States Congress has passed a banking bill, which is now law, that will give our Commissioner of Financial Regulation additional responsibilities. Although we cannot project the future of banking in Maryland, we can state the obvious—banks as we know them today will change. Due to the Federal Banking Modernization Act of 1999, banks will be able to engage in, or affiliate with, insurance and securities companies. Although the Commissioner of Financial Regulation has sufficient regulatory power over banks and their subsidiaries, it was not clear that current Maryland law provided the Commissioner regulatory authority over affiliates of banks after the action taken by Congress.

With the cooperation of the Maryland Bankers Association, House Bill 727 gives the Commissioner of Financial Regulation summary cease and desist powers with respect to any person engaged in lending, whether licensed or not, under the Maryland Consumer Lending Laws. This legislation will put our Commissioner of Financial Regulation on an equal playing field with the Insurance and Securities Commission.

We have witnessed over the past decades our bank teller become a bank machine, and now our bank machine will soon become a web site. We must carefully examine the void in financial services remaining in our communities and ask how and what is filling that void? Who among us is remaining behind? Are we creating a two-tier financial services system? On a parallel track we have seen our strong urban—neighborhoods suffer from urban flight and decay. Part of our solution in many transitional neighborhoods has been to encourage new homeowners. I recall the debate when former Secretary of Housing and Urban Development, Jack Kemp, wanted to turn public housing over to the tenants. Ownership is a laudable goal but successful home ownership requires building capacity. As state and federal policy makers we must help to build capacity. We must also examine the regulatory and enforcement powers we hold to ensure that timely detection and swift action can be taken to reduce harm in areas that I earlier referred to as "banking while poor."

Again, let me thank you for your time and attention to this serious matter. I am honored to have appeared before you today.

Senator MIKULSKI. What did you call it, banking while being poor?

Ms. MCINTOSH. Banking while poor. Unfortunately, I hate to say that. The bankers, the hair goes up on the back of their neck, because it is not our Federal and State chartered banks that have been a problem in the flipping. And they are now becoming victims in many instances. But yes, this is banking while poor. What are the services left in our communities when our local branches have moved out? And it is progress, I guess, to do banking on the Internet now, but there are a lot of people left behind in that progress.

Thank you.

Senator MIKULSKI. Delegate Rosenberg.

**STATEMENT OF SAMUEL I. ROSENBERG, DELEGATE, MARYLAND
HOUSE OF DELEGATES**

Mr. ROSENBERG. Thank you. As it is for my colleagues, it is an honor for me to be here today, as well. I have worked with both of you on housing issues in the past: condominium conversion, Section 8 conversion. And for the last 8 years, I have worked with Delegate McIntosh, representing northwest Baltimore City and County on a host of issues, and it has been my privilege. This is the first time I have worked with Delegate Krysiak, and she has been a real leader on this issue. And it really affects her neighborhoods. And she has chaired the subcommittee on economic matters, which has dealt with it.

Let me just address two points where I have been specifically involved, because we have had a long hearing. One is that of counseling. I chair the subcommittee on the appropriations committee in the House of Delegates that has the budget of the State housing requirements. So we have inserted language in the budget on the house side that requires that there be counseling and education on home buying if there are State dollars involved.

We have heard a lot of talk today, and very importantly, about the need to do that as well with FHA. But we are going to conference on our budget. And from what I have heard today, I am going to add more language, more than just counseling and education, but making sure that it is done early, that it is not done at the settlement table. So we are going to try to strengthen that language in the conference. And, at least if there are State dollars involved, that we can get that counseling in at the appropriate time, and perhaps even study some of these issues so we can create a better record for next year to deal with the appraisers, who are one of the big problems here.

Another version of this scam has to do with creating a trust in the name of a nonprofit. There have been some instances where the original property owner, the investment property owner, creates a trust in the name of Walters Art Gallery, without any knowledge of the Walters Art Gallery. So that when the unsuspecting buyer goes, wow, the Walters is involved in this; this must be a decent house that I am buying; they would not be involved in something like this.

So what we have done—and this legislation has passed out of the house and is awaiting action in the senate—is require that there be the written acceptance of a nonprofit when an instrument transferring property to that nonprofit or naming it as a beneficiary to an interest in the property. That is just one aspect of the problem, but I can see by your reaction that these people will go to great lengths and great imagination to try and take advantage of unsuspecting people. So as we try to deal with it in one area, it pops up in another.

PREPARED STATEMENT

I think the attention that has been focused on this problem, as Ken Strong said earlier, this is the blockbusting of the nineties now with the new millennium, and we need to address it because the neighborhoods are at risk. And I think, working together, we will solve this problem.

[The statement follows:]

PREPARED STATEMENT OF DELEGATE SAMUEL I. ROSENBERG

Senator Mikulski, Senator Sarbanes, and Members of the Subcommittee: Many of Baltimore's neighborhoods are suffering from a housing crisis. First-time home buyers have fallen prey to the unscrupulous real estate practice known as house flipping. Low-end homes are bought at bargain basement prices and quickly resold to inexperienced purchasers at highly inflated prices.

As part of the scam, the flipper engages the services of a mortgage broker and an appraiser. The broker often connects the buyer with an out-of-state firm specializing in high interest loans for buyers with poor credit. The home is falsely appraised at a higher value, enabling the buyer to qualify for a substantially higher mortgage.

Far too often, the buyer realizes the home is worth much less than the appraised value, is unable to continue making payments on the mortgage, and abandons the property. Preventing this kind of fraud is crucial to the well being of the Baltimore neighborhoods where this practice is concentrated.

In another version of the scam, the flipper creates a trust in the name of a non-profit organization, without its knowledge or consent. A purchaser is then induced into buying the property at an inflated price, falsely lured into the deal by the respectability derived from the association with the non-profit.

To prevent this, I introduced House Bill 1044, which would require that the written acceptance of a non-profit organization accompany an instrument transferring property to the 501(c)(3) or naming it as a beneficiary to an interest in property. The unknowing non-profit would no longer be an unwilling accessory to unscrupulous real estate schemes. This legislation has passed the House of Delegates and is awaiting action in the Senate.

I also had language inserted in the State operating budget requiring counseling and education on home buying for people who are using state funds to assist in their purchase.

Home buyers should be able to own a home without having to worry about scams that seek to defraud them through fraudulent appraisals, inflated prices and false representations. I welcome this subcommittee's interest in this issue and thank you for the opportunity to present my views on the flipping crisis in Baltimore City.

GREATER BALTIMORE BOARD OF REALTORS®, INC.,
Lutherville, MD, March 27, 2000.

The Honorable BARBARA A. MIKULSKI,
Subcommittee on VA-HUD and Independent Agencies,
Committee on Appropriations,
U.S. Senate,
Washington, DC 20510.

DEAR SENATOR MIKULSKI: On behalf of the 2,700 members of the Greater Baltimore Board of REALTORS® (GBBR), thank you for the opportunity to present written testimony before the Subcommittee on the issue of fraudulent real estate practices in Baltimore City. Enclosed please find our prepared testimony for the March 27, 2000 hearing. For your review I have also enclosed information on the exciting educational outreach campaign GBBR is undertaking with regards to this issue. If you have any questions or concerns about our testimony or the enclosed materials, please do not hesitate to call Carolyn Blanchard Cook, Director of Government Relations, at 410-337-7200.

Sincerely,

PATRICK J. KANE,
President.

PREPARED STATEMENT OF THE GREATER BALTIMORE BOARD OF REALTORS®

FRAUDULENT REAL ESTATE PRACTICES

On behalf of the 2,700 members of the Greater Baltimore Board of REALTORS® (GBBR), thank you for the opportunity to present this written testimony on such an important topic. At the outset, GBBR would stress that it does not condone any real estate practice that involves fraud and we, as a professional trade association, find it reprehensible that investors, appraisers and lenders were engaging in these kinds of practices. Furthermore, to the extent that all of the willing participants in these schemes can be identified, they should be held accountable under applicable law and regulation. GBBR would also stress that the overwhelming number of cases

involving real estate fraud were perpetrated by a handful of actors and that these practices are not indicative of the way the vast majority of real estate professionals conduct business.

Nevertheless, in response to the devastation that these fraudulent real estate practices are having on Baltimore's neighborhoods, GBBR convened an Issues Mobilization Task Force in November 1999. GBBR convened this Task Force for several reasons: First, the vast majority of these incidents have occurred without the use of a licensed real estate professional, licensed appraiser and homeownership counselor. However, all of these industries are being negatively impacted by these scams. Secondly, the real estate industry believes that it is important to state unequivocally that we as a collective industry of professionals will not tolerate fraudulent practices as a cost of doing business. Finally, GBBR believed it was important to bring the respective industries and interested parties together to develop ways to effectively end these fraudulent real estate practices. The Task Force is an ad-hoc coalition of some 45 individuals and organizations in the lending, appraisal, homeownership counseling and real estate industries, as well as community organizations and state and local elected officials.

To that end, the GBBR Task Force has focused its efforts primarily on the need to educate the public on the fraudulent scams that have been occurring and how to avoid these scams; as well as to work with other groups to encourage the Attorney General to Investigate these scams and prosecute the fraudulent practices under the State's consumer protection laws. GBBR has also been actively working with the Maryland Real Estate Commission to educate them on these scams and has received assurances that should these transactions involve licensed real estate agents, the Commission is committed to full disciplinary action where warranted.

For the most part, all of these transactions involved one thing: fraud. The sellers colluded with the appraisers to create an appraisal that far exceeded fair market value to justify a sales price that far exceeded fair market value. The seller then colluded with a mortgage broker to falsify the buyer's income, credit history and contract sales price so that the buyer could get not only the loan, but the loan at 100 percent of the sales price. In order to make these transactions happen, a lot of paper and information was falsified. All of this falsification amounts to fraud and is illegal under Maryland and federal law. The Consumer Protection Division is responsible for enforcing Maryland's Consumer Protection Law and we are glad to see that the Attorney General has stepped up to the plate and begun to actively investigate and hopefully prosecute these cases. GBBR is also pleased to see that the U.S. Attorney is also actively investigating these cases.

GBBR believes that a great number of the horror stories you have read about could have been eliminated if the buyers had been better educated on the homebuying process and how to exercise their rights under the real estate contract. To that end, we have developed a year long outreach campaign that will be targeted in those zip codes that are being hit the hardest by these fraudulent practices. The campaign will consist of multiple direct mailings, targeted bus advertisements, public service announcements and coordinated outreach with the faith communities in these zip codes. The thrust of the campaign will be the theme "Don't let buying your dream home become a Nightmare—contact a homeownership counselor or a REALTOR® before you sign the contract to purchase." In other words, bring on a professional before you get caught in one of these scams. A secondary theme in the campaign will be "not everyone is ready to buy today, but a homeownership counselor or a REALTOR® can get you into your dream home at a price and an interest rate that is right for you."

The Task Force is also focusing on this secondary theme because the real tragedies in these cases are those buyers who tried to do everything right. They talked with a REALTOR® and a housing counselor and because of credit issues or a lack of a down payment were told they were not ready to buy today—Not that they couldn't ever buy, but that they weren't ready today. And, disappointed, they went home. And in their mailbox they saw a flyer that said "You can own your dream home today, no money down, bad credit don't worry, etc." And instant gratification being what it is, they got sucked into the scam. Well the reality is that not everyone is ready today to become a homeowner. Lack of down payment and poor credit are two of the primary reasons why people can't buy today. But there are a whole bunch of good and decent counselors, REALTORS® and lenders who are willing to work with these buyers for the six months to a year that it might take to save for the down payment or straighten out the credit. And that is the message we are going to try and get out to the public with this educational campaign.

We anticipate that this campaign will cost in the neighborhood of about \$165,000 and will reach well over 360,000 people. The campaign itself is designed to hit our targeted audience multiple times over the next year so that the message "if it is

too good to be true, it probably is" stays before them for an extended period of time. GBBR has committed \$8,000 towards this effort and the Baltimore City Department of Housing and Community Development has made an initial commitment of \$15,000. We are asking our Task Force partners, members of our own organization and various other groups to also assist us in funding this important effort.

In short, we in the real estate industry, as well as all of us participating on the Task Force, are committed to doing what we can to stop these fraudulent practices. They do nothing but devastate entire neighborhoods and ruin the credit of those who have gotten caught up in the scams. And the message we want to leave with you is that we are collectively out front on this issue doing what we can to educate buyers on how the right way to become homeowners.

The 2,000 possibly suspect sales that were reported in the September 21 issue of the Sun are not all illegitimate sales. But, of those that were illegitimate, it is almost certain that these transactions involved some amount of fraud. Fraud is what the various governmental agencies need to focus on. Fraud can and should be prosecuted under existing law. Prosecute the handful of perpetrators of these fraudulent transactions and the problem is almost solved. Homebuyers can and should be educated on what they need to do to protect their investment. We at the Greater Baltimore Board of REALTORS® and the members of our Task Force invite you to join us in our efforts to better educate homebuyers on the homebuying process and we welcome your support of our efforts.

819 N. KENWOOD AVENUE,
Baltimore, MD, March 27, 2000.

Hon. BARBARA A. MIKULSKI,
U.S. Senator,
U.S. Committee on Appropriations,
501 East Pratt Street,
Suite 253,
Baltimore, MD 21202.

DEAR SENATOR MIKULSKI: My name is Ms. Darlene Glover and I am a victim of the "House Flipping", that has become a major concern for this committee and a major problem for the low-income, single-parent, unknowledgeable, residents of Baltimore City.

I was in attendance at today's hearing and I had the opportunity to hear several testimonies regarding this matter. I was hoping to be able to give my input on flipping and what I am going through. I was informed that this was not possible so I am submitting this letter, along with documentation on my case, to become part of the official record on this subcommittee.

My horror story started in 1996 and it is still haunting me today. The attached news article will give you and the subcommittee an idea of what I am going through. I have met with Mr. Carl Cleary of SECO several times with hope of obtaining some type of finance for rehab on my home but I keep running into brick walls. I am always available to help in anyway I can with killing this "House Flipping" epidemic.

Sincerely,

DARLENE GLOVER.

[From the Sun Staff]

A CRUEL LESSON IN HOME BUYING

(By John B. O'Donnell and Tom Pelton)

From her kitchen window in East Baltimore, Darlene Glover watched the junkies line up in the alley from dawn until well past dark to buy crack cocaine.

Her son watched, too. He was 9 years old.

Desperate to buy a home in a safer neighborhood but lacking good credit, the 42-year-old advertising assistant became a victim of real estate flipping—an increasingly common practice in which speculators buy shoddy homes and then rapidly sell them to naive purchasers for inflated prices.

Glover paid \$60,000—twice the amount she thought she was paying—for a problem-ridden house at 819 N. Kenwood Ave. that a speculator had purchased six months earlier for \$8,000, according to city records.

Today she's broke, more than \$60,000 in debt, and her dream of home ownership—"a picket fence, a dog and all that"—sits cold, dark and empty.

Now renting down the street, she finds the vacant house a painful reminder when she walks past.

"I feel embarrassed, I feel like I failed at something I wanted to do," said Glover. "It bothers me because I want to be a homeowner and leave something for my children. Now I live in an apartment, and that house is staring me in the face every day," she said.

Like hundreds of other Baltimoreans, Glover was burned by a real estate brush fire that has swept across struggling neighborhoods in recent years, cheating first-time homeowners, lenders and aspiring real estate investors.

More than 2,000 Baltimore houses have been bought and resold for more than double their purchase price in the past three years, the State Department of Assessments and Taxation says. In two major lawsuits, lenders claim that they were duped into providing mortgages that exceeded the value of the houses being financed.

A Sun examination of more than 400 flips found that many ads included falsified documents to make buyers appear creditworthy, inflated appraisals and sham second mortgages—all aimed at getting a loan for more than house was worth.

Federal and state investigations are under way, and, sources say federal investigators have gone beyond document examinations and begun to call in witnesses.

"I was scammed. I gave that lady all my trust," Glover said of Maxie Hoffman, who sold her the house.

Hoffman, 52, a landlord and speculator, lives in a waterfront home with a silver Porsche 924 parked in the driveway in the Chesaco Park neighborhood of Baltimore County.

"I don't really remember the case. It was a few years ago," Hoffman said in a brief interview concerning Glover. "She's probably exaggerating. I don't want to talk to you."

Hoffman said that she didn't do "anything wrong and added that she didn't know Glover had bad credit.

"The lady is not telling you the truth," Hoffman said, refusing to elaborate.

Need for unbiased help

Will Backstrom, a homeownership counselor for Neighborhood Housing Services in the Patterson Park area, said Glover has not been alone in misplacing her trust. It is not unusual for naive first-time buyers to rely on the seller in making key decisions. And that, he said, is the problem.

Glover "would never have gotten into that transaction if she had had a counselor who had no financial interest in the transaction," said Backstrom.

"The American dream is homeownership—but not at all costs. People who are thinking of buying a house should come to see us."

Glover is a tall, dignified woman from a middle-class neighborhood in West Baltimore. She flashes a brilliant smile and warm greeting to most people she meets, despite a painful injury to her left knee that makes her limp.

She wears an "I Love Jesus" pin on her long winter coat and has a large portrait of Jesus on her wall, not far from where her now-12-year-old son loves to play Nintendo video games.

Job, evening studies

At 7:50 am. weekdays, she catches bus No. 62 heading west on Madison Street to her \$24,000-a-year job as an assistant marketing coordinator for the architectural and engineering firm Daniel, Mann, Johnson and Mendenhall. At night, she takes computer classes at Sojourner-Douglass College.

"Most of my life, I've struggled," said Glover, a divorced mother of two. "I wanted to go to college, because I wanted to be a child psychologist. But my family didn't have the money for it.

"There are times when I get tired of being the breadwinner, the mother and the father. But I put my trust in the Lord and keep going."

Until 1997, Glover and her two sons lived in a rented rowhouse at 1620 E. Lanvale St. in the middle of a violent drug market.

She recalls hearing the pop of gunfire as two neighborhood boys, were shot to death on the corner near her home.

Audrey Wilkes, director of the community outreach program at Zion Hill Baptist Church, where Glover volunteered to help needy people, said Glover was brave to try to rescue her sons.

"Sometimes when I drove her home from church, drug dealers would literally be standing on the doorstep," Wilkes said. "She was a strong woman who wanted to do the right thing by moving to a better neighborhood."

Glover saw an ad in The Sun that offered a rent-to-buy deal for buyers with poor credit. She called Hoffman, who she said offered to sell her 819 N. Kenwood Ave. for \$29,200.

Exciting opportunity

She was excited about becoming a homeowner in a less dangerous neighborhood north of Patterson Park, despite her poor credit history and then salary of \$17,500.

On April 30, 1997, Glover signed on the dotted lines—many dotted lines.

She recalls the day vividly Hoffman picked her up at work she said.

On the drive to a Pikesville title company, Hoffman asked her whether she had \$6,000. When she said she didn't, Hoffman handed her six money orders worth \$1,000 each.

"She told me to make it look like it was mine," said Glover.

So Glover signed the money orders, put them in her purse and submitted them at settlement.

The document that outlines details of the deal lists the \$6,000—as "cash from buyer."

Glover was so ecstatic about owning a home that she didn't read everything she signed.

The Rev. Randolph Price, pastor of Zion Hill Baptist Church, recalled that his parishioners held a jubilant home-blessing ceremony for Glover, with two dozen people holding hands in a circle in her living room.

"We all told her she was blessed to buy that house," Price said. "But I guess we should all read the fine print."

Over the next year, Glover gradually learned the grim details of the agreement. The price was \$60,000—not \$29,200. She had signed two mortgages, not one, as she thought.

The first was a 30-year loan from One Stop Mortgage Inc., a Wyoming firm, with \$294 monthly payments and an interest rate of 11.7 percent that could rise to 18.7 percent but never decline.

"I felt stupid," Glover said. "I didn't want anybody to know. I didn't want my family to know."

Glover realized her dream house had become a frightening burden.

The house looked good when she bought it, with new carpeting and a fresh coat of white paint slapped over the wallpaper.

But it wasn't long before problems surfaced. The roof leaked into the second-floor bathroom, dislodging chunks of plaster. Most of the radiators and many electrical outlets didn't work. During the winter, the house became so cold that she and her sons could see the breath rising from their mouths in the living room.

The pipes to the bathtub weren't hooked up properly, so when she turned on the faucets water would ooze through the kitchen ceiling. The bathroom sink and kitchen counters weren't attached to the walls. The basement flooded; the shower spat only a trickle.

She moved into an apartment a half-block south on Kenwood Avenue, dreading the \$60,000 debt hanging over her head. The foreclosure suit was dismissed for lack of prosecution in August. But Glover is afraid to move back into the vacant home because the lender could resurrect it at anytime.

Impact on personality

Denise Murchison, Glover's sister, said Glover has suffered not only financially but also emotionally. Her normally free-spirited personality changed as she became more introverted and suspicious.

"She thought buying this house was such an accomplishment," said Murchison. "And then she found out it was just a rip-off. It was devastating. She doesn't trust anyone anymore."

[From The Sun, December 31, 1999]

HOMEBUYER SUES SELLER, ALLEGING FRAUD AND BREACH OF CONTRACT

(By Eric Siegel)

An East Baltimore woman who purchased a problem-ridden house for 7½ times what it had been sold for six months earlier has filed a lawsuit against the seller, alleging fraud and breach of contract.

The suit by homebuyer Darlene Glover says she was duped by seller Marie Hoffman into paying \$60,000 in 1997 for a house at 819 N. Kenwood Ave. in Patterson Park that Hoffman bought for \$8,000 six months earlier.

Filed Tuesday in Baltimore Circuit Court by Civil Justice Inc., a nonprofit legal advocacy group, the suit is the latest action targeting house "flipping"—a practice in which real estate speculators buy substandard properties and quickly sell them at excessive prices.

The practice is frequently accompanied by falsified documents and inflated appraisals.

Investigations into flipping have been launched by a U.S. Senate subcommittee and by three federal agencies—the FBI, the Postal Inspection Service and the U.S. Department of Housing and Urban Development—and the Maryland attorney general's office.

Lawsuits have been filed on behalf of dozens of homebuyers and lenders who claim they were deceived into offering mortgages that exceeded the value of the houses being financed.

Glover, 42, whose plight was detailed last month in *The Sun*, says in her lawsuit that she was told by Hoffman that the cost of the property would be \$29,200.

Glover also alleges that Hoffman improperly gave her six \$1,000 money orders to be used for a down payment on the house at settlement to make it appear that it was her money and that Hoffman failed to make promised repairs to the property.

The suit asks the court to rescind a \$24,500 second mortgage on the house from Glover to Hoffman and seeks another \$24,500 for repairs as well as punitive damages "in excess of \$25,000" for harm to her credit rating.

Glover, a \$17,500-a-year advertising assistant who moved out of the house after she fell behind on her mortgage payment and her lender filed foreclosure papers, said she hopes the lawsuit will help her erase her debt.

"I just want to get out of this situation, so I won't be held liable for the money, so it won't be held over my head," she said yesterday.

Efforts to reach Hoffman, a landlord who lives in Chesaco Park in eastern Baltimore County, were unsuccessful. Last month, she denied wrong doing in the sale and said Glover was "exaggerating."

The suit says Hoffman has been involved in as many as 100 transactions similar to the Glover sale.

Denis Murphy, executive director of Civil Justice, said the Glover lawsuit is the fourth such lawsuit he has filed.

Senator MIKULSKI. Thank you. Your testimony was excellent.

Senator SARBANES, how about you go first.

Senator SARBANES. Well, Madam Chairman, I, a long time ago, committed to give a speech over in Silver Spring very soon. So I am going to have to excuse myself. First of all, I will not be able to join you, unfortunately, on the tour. But I will get a full report about that.

I want to thank our three colleagues in government not only for their testimony, but for their efforts in the General Assembly to obtain State legislation. I think the message ought to be pretty loud and clear that these practices are going to be brought to a halt. I think the law enforcement agencies are moving with vigor and force, and they are already beginning to bring some people to justice. And I am sure others will be brought there as well. And I think the joint task force they have set up is a very important step, and perhaps a very significant development at the Federal level. And Senator Mikulski and I have been in communication with the Federal Reserve.

There was a speech that Alan Greenspan gave just last week in which they have now announced a multi-agency task force involving 10 agencies, including the Department of Justice, HUD, and the Federal Trade Commission. And Alan Greenspan gave a very sharp speech on this issue of predatory lending. And we intend to push hard on that initiative.

Senator Mikulski and I have been pressing the Fed on that for some time, and we are hopeful that out of that will come a renewed commitment by the regulators to move ahead in their support for actions in the legislative process as well. We have got to carve out these abusers who are exploiting people in an absolutely deplorable way. And they have moved in, and we are anxious to get people

into home ownership. We want to do that. That is an accomplishment. But they need to be brought into it in a reasonable way, appropriately counseled, so they are not taken advantage of and exploited.

And we have heard these examples here this morning, and I think it is imperative that we mount this joint effort both at the Federal and State level. And at the Federal level, both between the regulatory bodies and the executive branch and the legislative branch, to try to get at these practices. Some very sharp operators have been making a lot of money by, in effect, as the one woman said earlier, transforming what was their American dream into an American nightmare. And we do not intend for that to continue.

And I really commend Senator Mikulski for bringing the appropriations subcommittee here in order to have this hearing. It is a serious problem, obviously, in Baltimore, but it is happening elsewhere in the country, as well, and elsewhere in our State. And I know all three of these delegates, and I deeply appreciate their strong commitment to this issue.

Thank you very much. And if you will excuse me, Madam Chairman.

Senator MIKULSKI. Tell everybody in Silver Spring I said hi, and read the bottom line at any settlement.

I want to turn to some questions for our colleagues and for those in the audience. And I might say that this has been an excellent program with the people that have been the most affected speaking and Federal law enforcement, and of course our State response. And the question might be, where is HUD and where is the HUD I.G.?

We are going to be holding a hearing on Thursday in terms of the HUD appropriations. And a major focus of my questioning with Secretary Cuomo will be HUD and FHA. Flipping will be one component. So this is where we will deal with HUD. And we feel, rather than talking remotely, because flipping and FHA disposal is a national problem, we will deal with this Thursday. And we will be discussing this with Secretary Cuomo.

In addition to that, we are looking at lessons learned from VA. At no time in our testimony or our conversations does the VA mortgage program seem to be involved in flipping. This is another important Federal tool. And we want to know what is their framework for operation, where we could do lessons learned and apply it to FHA.

We have also, as Senator Sarbanes indicated, been in touch with Alan Greenspan. And also I have been in touch with Fannie Mae and Freddie Mac. Because the financial deregulation and, as ACORN so wonderfully said, there are the big guys, there are the out-of-state and maybe out-of-country banks, and then there are the little, itty-bitties that really masquerade as financial institutions, that then are predatory. And of course that goes to what you were saying, Delegate McIntosh, that there are organizations that perform a function and masquerade as if it were a financial institution. But they are also outside the regulatory framework. So we are looking at that.

The other thing we are looking at, and we will be talking with Secretary Cuomo and part of our afternoon walking around is HUD

as a landlord, HUD as a holder of last default, HUD as contributing to neighborhood decay through its disposal of what it then takes in. But we felt that was best used when we were out in the community. But we are interested in things like asset zones. How could nonprofits be involved? If they can flip so fast, why cannot HUD move those properties quickly to a nonprofit organization like Northwest Baltimore Corporation, the Park Heights, whoever, SECO, that wants to get into buying in bulk and then renovating, repairing and returning to the market at a fair value so that people can pursue home ownership?

Now, we are in it for the people and we are involved in the neighborhoods. Our whole interest is to prevent the gouging of the poor and neighborhood destabilization. Senator Sarbanes and I intend to be very persistent about this. I have 4 more years left in this term and a whole lot of life ready to go. Senator Sarbanes is on the brink of a 6-year term. So we are not here today and gone tomorrow. When the television cameras go, we are still going to be poring over your recommendations.

So, again, the message is to the flippers: If you are here, why do not you pack up and leave. And if you think about coming or moving to some other place, we are here. We are truly here. And knowing the three of you, we are going to be here a long time, too.

So then this takes me to a few of my questions. Delegate Krysiak, what I would like to ask you is about the appraiser. You spoke very firmly and very clearly and echoed, I know, my sentiment, which is the issue of, under FHA and the Federal Government, that if you buy a \$250,000 house, you get one kind of appraiser, but if you buy a \$65,000 house and then it is flipped, you get another. You said license is required in transactions valued at 250 or more.

Would you tell us what your recommendations would be at the Federal level?

Ms. KRYSIAK. Now, when you say two different kind of appraisals—

Senator MIKULSKI. I might have misspoke. You say in your testimony license is required for appraisals in transactions valued at \$250,000.

Ms. KRYSIAK. That is the Federal regulation. And Maryland follows Federal regulation. We do not have any regulation beyond that. We were proposing that everyone be regulated or that everyone be licensed. And the reason for that is because, as long as it is kind of a voluntary licensure, you do not have full enforcement powers. You do not have the money for enforcement. And you probably do not have the inclination to do it either.

And when you are dealing with smaller loans, that is the reason why many of us feel it is necessary for all appraisers to be required to have a license for any transaction.

Senator MIKULSKI. So require a license for all appraisers. And then also, I do not remember if it was Mr. Strong or Mr. Quayle who said that, for FHA, there should be an approved list of appraisers, so you could pick your appraiser. We do not want steering or whatever, but an approved list of essentially board-certified appraisers. Then you could get that. Would that be helpful?

Ms. KRYSIAK. Yes, that is a perfect solution, I think, to get objective appraiser in there rather than one hired by the lender and told what number to come up with.

Senator MIKULSKI. Could you then talk, you and any of the other delegates, about counseling? You heard again the recommendation that it be mandatory when a dollar amount or where the other—I believe it was Mr. Quayle who said, if there is a mortgage for 100 percent, that is where there should be counseling.

Ms. KRYSIAK. You know we are limited in what we can enforce upon private because, but I would try to enforce that counseling requirement in any way possible. I would say even where maybe it is not directly State dollars or Federal dollars, but somehow, in some way, we have given an incentive to banks or lending companies, that even that incentive would carry that obligation with it.

The other thing is what we did this term that I did not mention was we have passed an appraisers apprenticeship bill which would give us and future appraisers at least a uniform kind of education. As it is right now, there are some requirements, but maybe not as strict a training as we would like them to be. They train under another appraiser often, and it depends upon the quality of that appraiser.

So if you are regulated, they would have a better opportunity to oversee that training, as well, the department does.

Senator MIKULSKI. Thank you.

Do either of you two want to talk about the counseling issues?

Mr. ROSENBERG. As I pointed out, through the budget process, what we would hope we are going to be requiring the State, if there are any State dollars involved, that there be counseling.

Senator MIKULSKI. At what amount and at what level? In other words, if somebody is buying a \$300,000 home in Homewood or \$150,000 house in Ashburton or one of the other communities?

Mr. ROSENBERG. At this point, what we have put in on the house side says there should be counseling. But I am going to refine that in conference based upon what I have heard today.

Senator MIKULSKI. We cannot, at the Federal level, Delegate Rosenberg, say there shall be counseling.

Mr. ROSENBERG. At least through the budget process we can say, if there are State dollars involved.

Senator MIKULSKI. What is your recommendation on when counseling should be required?

Mr. ROSENBERG. I guess it would be whether it is at a certain level, whether it is \$100,000 or for first-time home buyers.

Senator MIKULSKI. And who should do the counseling? Should it be the bank?

Mr. ROSENBERG. No. Somebody independent. Somebody who does not have a stake in the transaction.

Ms. KRYSIAK. The nonprofits do it now. If we continue to use the nonprofits to do that but we gave them greater resources for training people to do it, it would help a great deal.

Senator MIKULSKI. But you think it is also important to have HUD-certified nonprofits. Because, let me say this, where there is greed, there is scam. And so, Delegate Rosenberg, your outstanding testimony in terms of involving a nonprofit like Walters or maybe even a community development corporation or a beloved hospital in

the community, like a Mercy or a Sinai, and people are being gouged because they think, oh, wow.

Now people are going to invent nonprofits. They are going to say they are the All Saints and Rescue the Sinners nonprofit counseling. And they are going to want a fee because there will have to be some type. Private philanthropy should not carry that load by itself. And so there will be gougers. Do you think that will be important?

Ms. KRYSIAK. Absolutely.

Ms. MCINTOSH. Particularly those that have had some history in home ownership or housing as a part of their mission, which we have several.

Senator MIKULSKI. I know we have several. What about the mortgage brokers? What do you think we ought to do with them?

Ms. MCINTOSH. Well, the mortgage brokers actually, in the regulatory bill that I introduced, I want to make it clear that the financial commissioner now will have the ability to move in and have a cease and desist order over someone who is unlicensed—unlicensed as well as licensed—under her purview. But I do want to go back again and say that this is not appraisers. The appraisers are not under the banking commissioner. So we do have a hole there.

But in terms of the mortgage brokers, I think, one, the regulatory process now and in the years to come will be is if there is any complaint or suspicion, they will be able to move in whether they are a licensed or unlicensed mortgage broker and do an investigation and even stop a transaction. So that I think, from a regulatory perspective, we have hopefully fixed a problem.

But I think Delegate Krysiak pointed out that part of the problem was also that one broker can have many, many loan initiators, which we need to look very carefully at.

Senator MIKULSKI. Well, I know this is a work in progress. And when the session is over, we will be interested in what passed and also your lessons learned from the testimony. And we are welcome to ongoing conversation.

I want to go into neighborhood recovery for just a few questions, and then we will conclude. Availability of credit to poor people is a big issue. As a young social worker, working in the war on poverty and a parishioner at St. Gregory's Church in west Baltimore, with a beloved priest named Father Joe Connelly, one thing we at the parish council identified was access to credit and that people, because of redlining, could not buy a home, and also because of segregation, which was the worst of redlining. And there was no way to get credit, not only to buy a home or business, but you would have the loan sharks. And they had Happy Harry.

And one of the reasons Harry was so happy was that on payday he would come in and do loans at 20 and 30 percent. We established a credit union in the neighborhood and, in many instances, it was the establishment of credit unions in faith-based organizations that helped. But they could never be a bank by proxy and had certain limitations.

It is regrettable that 30 years later I am having the same conversation with you. Thirty years later, it is the same conversation. The usury continues. The scams are more sophisticated. But, again,

it is a failure to really have financial services in all of our communities. That is a whole other issue.

Let us go to neighborhood recovery. Delegate Krysiak, you talked about in your testimony community recovery, the fact that HUD houses are a problem. Do you have thoughts on that? Because I know you all are in session and will not be able to come with us.

Ms. KRYSIAK. As a matter of fact, we General Assembly at 2:00, and some of us have to be there earlier than that.

The HUD houses, if we could turn them over faster, even if you could turn them over to an Ed Rutkowski or turn them over to a Southeast Development or some organization that would at least maintain the appearance of a house until they are able to either get it in condition to rent or sell. And I think if you will read through Mr. Rutkowski's testimony, he tells you that in these areas where they have had difficulty, you might want to fix them up and rent them a little while until we recover the reputation of the neighborhood and can then sell.

But the HUD houses do not look good. That is a big problem. If you walk past these houses and there is a piece of paper stuck on the dirty window and the house is just in disrepair, that does not do anybody any good. It would be better off for the community if those houses got into the hands of the community as quickly as possible. And we have not just the CDC's, we have community organizations that could take on the responsibility for a house here and there and could get it into condition so it is habitable again.

Senator MIKULSKI. Well, these are things we have to look at carefully. I am not so sure we can do a house here or there. And we are really going to look to you and the coalition on what is the best way or the minimum number to maximize the Federal value.

Did any of you wish to comment on the HUD houses, because you represent a variety of areas?

Well, let me conclude with just one last comment about the FHA inspectors. I agree, Delegate Krysiak, but it is not the big homes that are going to sell for \$300,000 or \$400,000, where they are going to be fussing. But there is between what I call the 100 or, again, depending on how solid is the zip code, anywhere from \$85,000, where the house is really worth 85, up to \$175,000 or \$185,000, where they fuss. It is different than a home inspection. But, again, what we heard from Ms. Wonson, plumbing, roofs, what we have heard from Ms. Adams and Ms. Simon, and so on. And it is reminiscent of the S&L crisis.

You and I come from a community where, because of the red-lining of the Polish community 100 years ago, our own folks were able to pool their money and start S&L's because we could not get loans without them. There was a reason we had names like the Copernicus Savings & Loan and the White Eagle Savings & Loan, and it was affectionately called the Polish Wall Street.

Ms. KRYSIAK. White Eagle was my family.

Senator MIKULSKI. Koziusko was mine. But I am also familiar that in the height of the S&L debacle, you would have inspectors come in and spend 3 to 5 days at a small ethnic savings and loan that had no history of foreclosure in maybe a decade, and yet we had Old Court and some of the others. And so I hope we are not developing this same pattern and practice here, which is where

there is scam and scum, there is the avoiding and only the unlicensed, bribed appraisers who are there, and others are just fussing around with others. Because the whole idea of an appraiser is to tell you what you need. And the whole idea of a home inspection is an excellent tool often for the buyer.

I know someone who wanted to sell a home when their mother died in east Baltimore. The home inspection told them things about the home they did not know. So they wanted to do the right thing because they knew it meant neighborhood stabilization and sold to a young couple through one of the programs.

So we are on this. But those are other issues. Again, you really have led the Nation in coming up with solutions. To my knowledge, the leadership in the Maryland General Assembly, represented by you three at the table, is one of the first responses at a State government level nationwide. I really would like to salute you. Thank you for what you have already briefed the committee on—lessons learned as you go through. And again, I thank you for not only what you are doing for the people of Maryland, but these are extraordinarily helpful in terms of serving the Nation. Thank you.

And I want you to be there for your roll call. This concludes this part of the hearing. And the official record will conclude at this time and I will call it into adjournment. I will be joining the residents for a walk-through of the North Robinson Street area. And we will be with the community leaders and any of the press who chooses to come, as well as Senator Sarbanes' staff, if they would like, we would very much welcome their presentation.

As I conclude this hearing, I want to thank each and every one who testified and each and every one who already is making a service to the Nation, to the community groups who brought this to our attention, to the wonderful people from the community who put their embarrassment aside to be able to come and discuss this with us, to Federal law enforcement, to, again, our delegates. They have made an outstanding contribution.

We will continue the hearing with Andrew Cuomo on Thursday. We will be looking at all of his appropriations. But I will be focusing on FHA, FHA as a tool, as a rung in the ladder of opportunity for home ownership. Because we want to be sure we keep that going and do not so shackle it that we then work against our desire for home ownership in America. But also HUD as an FHA landlord, and creative ways that they can work with community organizations to restore neighborhoods and bring housing back to the market that is fit for duty.

And last but not at all least, what we are going to do about the flipping. And I want to say to the people of Baltimore, we are highlighting you, but this is not only your problem. This is a national problem. It is going to require national solutions. We intend to pursue flippers this year, next year if we have to, and the third year after that and the fourth year. If we have to go to the Cayman Islands to find you, we are going to be on this.

ADDITIONAL SUBMITTED STATEMENT

The subcommittee has received a statement from E. Barry Skolnick which will be included in the record at this point.

[The statement follows:]

PREPARED STATEMENT OF E. BARRY SKOLNICK, M.S., FAIR HOUSING DIRECTOR,
NATIONAL COMMUNITY REINVESTMENT COALITION

Introduction

To Ranking Member Mikulski of the Subcommittee on VA, HUD and Independent Agencies of the Committee on Appropriation, U.S. Senate; and to Senator Sarbanes, attending. This writing is hereby submitted as invited by Senator Mikulski's letter dated March 26, 2000 in lieu of oral testimony, and subsequent to the Field Hearing's scheduled date, to represent my personal views as a concerned resident of Baltimore City and as an experienced technical analyst in the field of private enforcement of the nation's fair housing laws, concerning "Real Estate Flipping", which was the subject of the Subcommittee's Field Hearing convened in Baltimore, Maryland on March 27, 2000, which I personally attended.

I am at present employed as the Fair Housing Director of the National Community Reinvestment Coalition (NCRC), Washington DC, and this position gives me added depth of perspective on this issue of "property flipping". Previously I was data analyst and co-author of the 1998 Home Mortgage Disclosure Act (HMDA) data-based fair lending report, *Fair Lending in Montgomery County: A Home Mortgage Lending Study*, produced with Zina G. Greene and Carmen-Rosa Torres under contract for the Montgomery County, Maryland Human Relations Commission. I have also worked on the national staff of ACORN Fair Housing, Inc., Washington, DC.

A. Racial basis of predatory practices including "property flipping"

I applaud the Senate Subcommittee's newly-focused attention on this issue of "real estate flipping"—or more specifically residential "property flipping"—which unfortunately appears to be a newly-needed term in the recognized lexicon of abusive real estate industry practices generally known as "predatory lending".¹ The term "flipping" has been generally understood to apply to subprime home mortgage loans, and was defined by Atlanta attorney William J. Brennan as involving "successive, repeated refinancing of [a] loan by rolling the balance of the existing loan into a new loan instead of simply making a separate, new loan for the new amount and always results in higher costs to the borrower."² As described in harrowing detail in this Field Hearing's oral testimony and in recent investigative journalism published in the *Baltimore Sun*³ and elsewhere, this newly-recognized (if not newly-invasive) predatory real estate practice of "property flipping" must now be distinguished from loan "flipping", although it is closely associated with many of the same abusive "predatory lending" practices as is the latter.

One attribute manifestly shared by both property flipping and other prevalent predatory lending practices is race-based targeting—as is suggested by the "thematic" map of Baltimore City's 1995–99 property-flipping activity presented in today's testimony by Mr. Strong representing the Southeast Community Organization (and reportedly based on technical assistance provided by HUD Community Builder Carmen-Rosa Torres, Ph.D.): this map compares well to maps of subprime loan origination data, prepared in investigations of allegedly predatory lenders.⁴

Such thematic maps, which visually compare the geographic distribution of allegedly predatory activity (e.g. "flipped" properties, refinanced loans) against the racial distribution or median income of U.S. Census Block Groups in the studied urban area, characteristically reveal that the sales or loan activity is disproportionately concentrated in high-minority or "turning" areas (i.e. perceptibly changing from predominantly White to predominantly minority populations, as had occurred en masse in West Baltimore, during the notorious "blockbusting" days of the 1960's), while such activity is minimal or absent in nearby non-minority residential areas having similar demographic income characteristics. As a matter of technical analysis, it has been rather difficult for analysts to obtain through local sources the kind of

¹ For a seminal description and discussion of "predatory lending" abusive practices, see the proceedings and testimony before the Senate Select Committee on Aging on "Equity Predators: Stripping, Flipping and Packing Their Way to Profits", March 16, 1998 (On-line Ref. URL: <<http://www.senate.gov/~aging/hr14.htm>>)

² Ibid. See the 32-point annotated list of abusive practices presented in the testimony of William J. Brennan, Jr., Atlanta Legal Aid Society, Inc. "Home Equity Lending Abuses in the Subprime Mortgage Industry", March 16, 1998 (On-line Ref. URL: <<http://www.senate.gov/~aging/hr14wb.htm>>)

³ E.g. John B. O'Donnell, "5 Face Charges in 'Flip' Scheme", *Baltimore Sun*, March 9, 2000 (on-line URL: <<http://www.sunspot.net/cgi-bin/gx.cgi/AppLogic+FTContentServer?section=archive&pagename=story&storyid=1150280204272>>)

⁴ Examples are Ford Consumer Finance Company's loan activity in Atlanta, as investigated by the Atlanta Legal Aid Society; and Delta Funding Corporation's activity in New York City, the subject of recently-settled state and Federal investigations (see URL: <<http://www.hud.gov/pressrel/pr00-67.html>>).

“pinmapped” (i.e. localized or “geocoded” to street address geographic coordinates) loan or sales data which is needed to produce such detailed maps of activities comparable to demographics resolved to the Block Group level. Access to such data must be facilitated if effective analysis of predatory “flipping” and lending practices is to be performed more frequently and effectively nationwide.

Similar (if less well-resolved) maps of subprime loan application or origination data can be much more easily prepared using nationally-reported Home Mortgage Disclosure Act (HMDA) data, and available geographic information systems (GIS) “mapping” software. Unfortunately, HMDA data collected annually through the several Federal regulatory agencies by the Federal Financial Institutions Examinations Council (FFIEC) is required to be reported as localized only to Census Tract geographies, and so can only be mapped against Census Tract demographic ranges for Race/National Origin or income, etc. This tract-level resolution is often not sufficiently detailed to accurately reflect community and neighborhood boundaries “on the ground” in our nations congested urban areas. Best use of such nationally-collected loan data (or any comparable residential property sales data) in support of effective regulation and anti-predatory lending oversight and enforcement would surely be much better served if loan geographies were routinely reported to FFIEC and published localized at the Census Block Group level, if not by street address (an alternative rightly precluded by privacy considerations).

B. Applicability of anti-discrimination laws to predatory practices including “property flipping”

Future investigations will likely demonstrate that such apparently race-based marketing and targeting of predatory real estate activities—including property flipping as well as various abusive lending practices—will prove to be the rule rather than the exception—perhaps matched only by a similar tendency to target the elderly in such fraudulent real estate-related schemes. Evidence of the disproportionate minority impact of these practices—such as was compellingly represented at this Field Hearing by the personal testimonies of minority victims, and by the convincing maps of Baltimore’s cumulative property-flipping activity—is surely a “smoking gun” for unlawful acts of racial discrimination, falling within the scope of existing civil rights laws.

This argument for the applicability of Federal civil rights, anti-discrimination, and fair housing laws to predatory practices in lending and property flipping, contrasts with that expressed by representatives of the three Federal enforcement agencies who testified at this Field Hearing—agents representing the Department of Justice, the Federal Bureau of Investigation, and the U.S. Postal Service—who spoke only of mail and wire fraud statutes, when asked by Senator Sarbanes what violations of Federal law were under active investigation by the five regional interagency task forces now constituted and actively investigating predatory lending throughout the Nation.

In contrast, the Department of Justice (DOJ), in an amicus curiae brief filed very recently in Federal district court,⁵ has presented an interpretation of the Fair Housing Act and the Equal Credit Opportunity Act (ECOA) by which “reverse redlining” (the “practice of targeting minority communities for predatory lending”) . . . “can violate the Fair Housing Act” and ECOA; and that “statistical evidence of targeting can be sufficient to raise a factual dispute of intentional discrimination” in the case at issue. In its brief, DOJ states, “In our view . . . “predatory lending” is sufficiently identifiable such that, when its victims are selected based on race, it constitutes discrimination.” From the factual and statistical evidence presented in testimony at this Field Hearing, both orally and in “thematic” maps of Baltimore City presented by Mr. Strong and demonstrating the obvious coincidence of clustered property-flipping sales with high-minority residential communities (as represented by 1990 U.S. Census Block Group demographics), it is clearly evident that property-flipping practices—like predatory lending—will be found to similarly satisfy the DOJ’s newly-expressed criteria for “constituting discrimination,” and thus will be found to justify the sanctions of law for violations of civil rights.

There is indeed a valuable role played by responsible subprime lenders in providing credit access and homeownership to many traditionally-underserved Americans; likewise, there is an essential place for the purchase and quality rehabilitation

⁵ U.S. Department of Justice, Civil Rights Division, Housing and Civil Enforcement Section: Brief of the United States as Amicus Curiae in Support of Plaintiffs’ Opposition to Defendants’ Motion for Judgment on the Pleadings or, in the Alternative, for Summary Judgment, *Hargraves v. Capital City Mortgage Corp.*, No. 98-1021 (D.D.C., brief filed Mar. 10, 2000), 45 pp.

of deteriorated residential property for responsible resale as much-needed affordable housing in the nation's disadvantaged communities.

However, the pain and growing prevalence of Baltimore's property-flipping problem, as has been so well portrayed by victims, community advocates and Federal enforcement authorities alike at this Field Hearing, makes it is clear that Federal and local governments should urgently begin to apply vigorously and fully utilize the nation's civil rights laws as additional tools for effectively combating the now-recognized scourge of property flipping, as well as the full range of predatory and abusive (if highly profitable) subprime lending practices—the past unbridled success of which may have spawned this—to use Senator Mikulski's aptly-applied term—“despicable” practice of “property flipping”.

CONCLUSION OF HEARING

Senator MIKULSKI. So thank you very much. The subcommittee stands recessed until Thursday, March 30. Thank you.

[Whereupon, at 12:20 p.m., Monday, March 27, the hearing was concluded, and the subcommittee was recessed, to reconvene subject to the call of the Chair.]

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